



# **Common Ownership Community Manual & Resource Guide**

**Prepared by the Montgomery County**

**Commission on Common  
Ownership Communities**

**2005**

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## **INTRODUCTION**

In the last 40 years, self-governing residential communities have evolved and flourished in Montgomery County, Maryland. Currently, there are over 1,000 homeowner/ condominium associations in the county, containing approximately 340,000 residents. How these associations are governed directly affects the quality of life of every resident.

In Montgomery County, these associations are authorized to provide for self-government and mandatory membership through which open spaces, privately owned streets, parking, recreation and other facilities are owned, maintained and governed. In many cases the association's authority extends onto each privately owned lot and residence with regard to its external use, appearance, maintenance and repair. These associations have the authority under Maryland and County laws to adopt and enforce rules and regulations for the architectural design and private use of common and private owned property in the association; assess annual dues for the maintenance of the common property and the operations of the association; and, hold its members individually accountable for violations of the rules and covenants of the community. Each property or lot and its residents, or condominium residential unit, is seen as an integral, valuable, and contributing part of the community. In return, the association maintains and protects the community standards and its intrinsic residential values.

These associations vary in size, type of living unit, composition of the common areas and facilities, and scope of responsibilities. The situations encountered by community associations vary widely according to the:

- 1) Structure and requirements of the governing documents;
- 2) Organizational assistance and resources provided by the developer during transition to the owners;
- 3) Experience of the association board members;
- 4) Type and quality of management used by the association; and
- 5) Cooperation and involvement of association members.

In some communities, collecting annual assessments, maintaining financial and meeting records, and enforcing covenants encompasses the community's responsibilities. In others, community responsibilities are more extensive and may include the use and maintenance of open areas and spaces, repair or replacement of recreation facilities, private streets and parking lots, facilities and other amenities in the development, and contracting for services including professional management. Condominium associations may also provide for exterior building maintenance, master-meter utilities, common heating systems, laundry and storage facilities, and other needs of the owners.

This Montgomery County Common Ownership Communities Manual is intended to focus is on mandatory membership homeowners and condominium associations in the County. Other types of associations, such as civic associations, cooperatives, time-

shares, mobile home parks, recreational clubs and the like, are not addressed in this manual.

Montgomery County leads the nation in providing a hospitable, progressive system of self-governance for common ownership communities. They are a real-life experience in democracy on the local level. As a result, they may from time to time experience the same types of controversies, tension, and acrimony that exists in our larger society.

This manual is intended to consolidate the collective experience and knowledge of common ownership communities to serve as a resource for all common ownership community participants – in Montgomery County, Maryland and beyond – so we can continue to enjoy and share the challenges and pleasure of living in a self-governed community.

Harold Huggins  
Chairman  
CCOC  
August 2005

## **ACKNOWLEDGMENTS**

We are very fortunate to live in Montgomery County, Maryland, a community in which volunteerism and participation in public life continues to be considered a noble deed and personal responsibility. As mentioned in the Introduction, *supra*, this manual is a compilation of valuable information about governing and living in a homeowner/condominium association environment. It is brought to you by the Montgomery County Commission on Common Ownership Communities (CCOC), and although the CCOC may claim ownership of the manual, it is the volunteers from outside and within the CCOC who gave it life. We tapped property managers, insurance agents, attorneys, accountants, engineers, government officials, laypersons and our own membership to assist in writing, coordinating, reviewing, and editing the information found in these pages. We are most grateful to them for sharing their valuable time and expertise with us and for helping bring this worthwhile endeavor to fruition.

The CCOC wishes to thank Richard Leeds, CCOC member, past Chairman, and Manual Committee Chair, for suggesting this project, sharing his knowledge, and using his power of persuasion to interest the many people listed below that assisted the CCOC in this producing this manual. This project would not have been undertaken without Richard's belief in the community-wide value of this material, his belief in community associations, and his persistence in obtaining the finished product from the contributors and the CCOC. The dedicated individuals listed below have our thanks and gratitude for seeing this project to fruition.

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Reserves	Doug White
Transition from Developer Control	Doug White, David Mercer, Esq.
Assessment Collection	Jack McCabe, Esq.
Financial Procedures, Investments, Asset Protection	Jody Vilardo, Howard Goldklang Leesa Weiss, Esq.
Governing Documents Annual Meeting, Special Meetings, Board Meetings, Directors Code of Conduct And Board Meeting Ethics	Michael Nagle Shelah Lynn, Esq. Craig Wilson, Larry Gaffigan
Contracts	
Management Overview	
Building Community— Owner/Leader Perspective	Leesa Weiss, Esq.
Management Perspective	Ed Thomas
Hiring and Discharging	Joe Douglass
Fair Housing	Joe Douglass

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Legal Risk Management  
Snow Removal  
Legal Services Management  
ADA

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Eric Smith  
  
Jeffrey Van Grack, Esq.

A special thank you goes to the Fairfax County Department of Cable Communications and Consumer Protection for sharing the “Fairfax County Community Association Manual” with the CCOC. This document was an invaluable tool to follow in crafting the “Montgomery County Community Association Manual.”

Our goal was a simple one, to provide the residents of Montgomery County with a manual that would be informative, helpful and user friendly. We welcome your comments and suggestions for future improvements.

**Acknowledgement Letter(s) from  
County Executive/County Council**

## **Detailed Chapter Outlines**

### **Ch. 1: Association Organization: Governing Standards and Documents**

#### **I. Maryland and Montgomery County statutes/codes; discussion of salient portions of each**

- A. Maryland Condominium Act
- B. Maryland Homeowners Association Act
- C. Maryland Corporation Act
- D. Co-operatives (applicable Maryland law)
- E. Montgomery County Code
  - 1. Section 10B
  - 2. Section 24
  - 3. Developer control
  - 4. County's administrative procedures
  - 5. Zoning Regulations

#### **II. Governing Documents**

- A. Declaration: includes
  - 1. Description
  - 2. Plats
  - 3. Defining membership requirements and obligations
  - 4. Assigning/Defining voting rights of each type of association member
  - 5. Covenants, Conditions and Restrictions
  - 6. Method for amendments
- B. Bylaws
- C. Master Deeds
- D. Articles of Incorporation
- E. Rules
  - 1. Method for adoption
  - 2. Bases for rules in governing documents
  - 3. Architectural guidelines and use limitations

#### **III. Association Disclosure Requirements**

- A. Condominiums
- B. Homeowner Associations
- C. Cooperatives
- D. Securities/Public Offering Statement

### **Ch. 2 - Building a Strong Community: The Owner Perspective and the Manager Perspective**



## The Owner Perspective

### I. Building & Providing Leadership

- A. Board members as community leaders
- B. Developing and utilizing a committee system
- C. Encouraging community volunteers as future community leaders

### II. Nurturing Relationships

- A. The inclusive Board
- B. Enhancing relationships between owners and association leadership

### III. Education About the Community Association Concept

- A. Educating Board and Committee Members
- B. Educating Owners

### IV. Governing Reasonably

- A. Rules should be logical, sensible and sound
- B. Is “the letter of the law” necessary or does it need to be changed?

### V. Practicing Justice for All

- A. Fair hearings
- B. Right of appeal before imposing fines or other “punishment”
- C. Understanding the requirements of the Maryland Condominium Act, Maryland Homeowners Association Act, and Montgomery County Code

### VI. Encouraging Consensus

- A. Identifying controversial issues and engaging in interactive communication with the community
- B. Seeking community input prior to controversial decisions by the Board
- C. Understanding minority views

### VII. Preventing & Resolving Conflicts

#### A. Alternative Dispute Resolution (ADR)

- 1. Mediation
- 2. Arbitration

#### B. Dealing with the community gadfly

### VIII. Positive Reinforcement for Volunteer Efforts

- A. Empower volunteers
- B. Public appreciation of volunteers

## **Ch. 3 - Board, Annual and Special Meetings**

### **I. Annual Meetings and Special Meetings**

- A. Notice
- B. Proxies
- C. Quorum
- D. Conduct of meeting
- E. Minutes

### **II. ELECTIONS**

- A. Nominations
- B. Candidate forum
- C. Voting
- D. Election records

### **III. BOARD MEETINGS**

- A. Notice
- B. Quorum
- C. Proxies
- D. Order of Business/Agenda
- E. Owner Forum
- F. Executive Session

#### **G. Minutes**

- 1. Taping
- 2. Content
- 3. Approval
- 4. Official record

#### **H. Policies and Procedures Manual**

### **IV. Board & Committee Code of Conduct (Michael Nagle)**

### **V. Board & Committee Code of Ethics (Michael Nagle)**

## **Ch. 4 - Management Companies: Their Role in Community Associations (Larry Gaffigan)**

- I. Executive Statement
- II. Obligations Inherent in Board Service
- III. Viable Allocation of Responsibilities
- IV. Duties of All Board Members
- V. Liaison with Management Agent
- VI. Making the Work Comfortable and Productive
- VII. Meaningful Communication
- VIII. Effective Operational Governance

- IX. Community Specific Planning
- X. Sound Financial Oversight
- XI. Role of Management Agent
- XII. Management Philosophy
- XIII. Management Contract
- XIV. Transition
- XV. Welcome to your Associations Board of Directors
- XVI. Fiduciary Obligations of Directors
- XVII. Liability and Risk Management
- XVIII. Avoiding Conflicts of Interest
- XIX. The Work of the Board
- XX. Prudent Fiscal Oversight
- XXI. Communication with Membership
- XXII. Understanding Financial Statements
- XXIII. Replacement Reserves
- XXIV. Elections

## **Ch. 5 - Using Your Legal Resources to Protect the Association (Shelah Lynn)**

### **I. Contracting Issues**

- A. Forms
- B. Details
- C. Lump Sum Payments
- D. Indemnification
- E. Independent Contractor
- F. Liability Insurance
- H. Workers' Compensation Insurance
- I. Termination
- J. Checklist
- K. Starting and Completion Date
- L. Fidelity Bond
- M. Warranty
- N. Addenda
- O. Attorney Review
- P. Governing Law
- Q. Severability
- R. Integration
- S. Assignments
- T. Litigation
- U. Dispute resolution Mechanisms

## **Ch. 6 - Insurance Issues For Community Associations**

### **I. General Discussion of Relevant Concepts**

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- A. Pollution issues including mold, asbestos & UST
- B. Terrorism
- C. Fidelity Coverage and Computer Fraud
- D. Forms of Insurance Normally Purchased: Property, Liability, Fidelity, Personnel including WC, Equipment, and D&O
- E. Where to Look for Insurance Issues: Statutory Provisions, Secondary Lending, By-Laws and Good Business Judgment Rule
- F. Risk Management Benefits
- G. E&S Markets
- H. Explanation of terms including coinsurance, single entity, Bld. Ord., All Risk and Named Peril, Waiver of Sub., Cross Liability and Severability of Interest
- I. The claims/adjustment process
- J. Contractual responsibilities for the insured and insurer at time of loss
- K. Reservation of rights letters
- L. Financial ratings and rating agencies
- M. The CGL with all its endorsements
- N. The MD Insurance Administration
- O. Duty to Maintain insurance coverage
- P. Market Conditions and the Budget Process
- Q. Named Insured v. additional insureds
- R. National Flood Association
- S. Certificate of Insurance
- T. Underwriting and the reinsurance market
- U. Deductibles and who pays them
- V. Insurance Trustee
- W. Claims and who gets paid. Commercial Auto used to transport residence.
- X. Master Policy and Primacy issues.
- Y. Proof of Loss forms
- Z. Occurrence vs. Claims Made Policies
- AA. Cancellation Provisions
- BB. Self Insurance

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- I. Description of types of storm water management facilities located on community association property.
- II. Determining whether the community association is responsible for the maintenance of the storm water management facility.
- III. Assumption of responsibility for structural maintenance of the facilities by the County - Montgomery County Code Ch. 19.
- IV. Takeover Process.

- A. Preparing and executing the necessary new agreements or amendments to existing agreements
  - B. Submitting the agreements to the County for execution by the County Executive
  - C. Obtaining inspections of the facilities and making any necessary structural repairs
  - D. Recording the agreements
  - E. Submitting to the County a completed application with certified copies of the recorded agreements
  - F. Certification from the County that all necessary structural repairs have been completed and the responsibility for structural maintenance of the facility will be assumed by the County
  - G. Continuing responsibility for non-structural maintenance such as landscaping
- V. Water quality protection charge
- VI. Differences between storm water management facilities for homeowners associations and condominiums
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- I. History
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  - B. 1988 Amendments
- II. Prohibited Discrimination
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- II. Accounting systems and required documents
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  - B. Accrual Accounting
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- III. Financial Statements
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    - B. Liabilities
    - C. Equity
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      2. Reserve fund
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  - b. Statement of Income and Expenses
    - A. Period and year-to-date
    - B. Vs. budget
  - c. Statement of Cash Flows
    - A. Often not included in monthly statements
- IV. Monthly Financial Package  
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  - d. General ledger activity and journal entries
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  - f. Bank reconciliations
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- V. Audits and their requirements
  - a. AICPA audit guide for CIRAs
  - b. Contents of a standard audit report
    - A. Opinion
    - B. Balance Sheet
    - C. Statement of Revenues, Expenses and Changes in Members Equity  
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    - D. Footnotes
    - E. Supplementary Information on Future Major Repairs and Replacements
  - c. Presentation of fund accounting, separation of activities and balance sheet for operating vs. reserve fund columns
  - d. Representation letter
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  - a. Discussion of filing alternatives, status of CIRAs as incorporated or non-incorporated
    - A. 501(c)(4), 501 (c)(7) or 501 (c)(12), for Form 990. Few CIRAs meet the criteria to file as a tax-exempt organization
    - B. Section 528, Form 1120H
      - 1. Discussion of considerations, tax rate
    - C. Section 277, for 1120
      - 1. Discussion of considerations, tax rate
  - b. Importance of filing timely
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    - B. Estimated payments
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  - b. Legal documents outline investment parameters
  - c. Key elements of investments
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    - B. Liquidity – definition
    - C. Yield – definition
  - d. Risks
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    - D. Liquidity risk – availability of funds
    - E. Interest rate risk – rates decrease over time
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    - B. Money Market deposits and funds
    - C. US Treasuries and US treasury strips
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  - B. Annual assessments/special assessments
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  - D. Statutory limitations on assessing interest and late fees
  - E. Right to accelerate annual assessment
  - F. Collection policies and application of payments to outstanding indebtedness
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    - 2. Actions in Circuit Court.
      - a. To challenge imposition of lien
      - b. To foreclose on lien
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    - 1. Small claim/large claim
    - 2. Collection options once a judgment is obtained.
  - C. Advantages/Disadvantages of each approach
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  - B. Chapter 13
  - C. Proofs of Claim
  - D. Motions for Relief for Automatic Stay
  - E. Discharge.

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- II. Budget Philosophies
  - A. Level of Detail
  - B. Line item budgets
  - C. Program budgets
  - D. Budgets and accounting
- III. Budget Preparation Timetable
- IV. Preparing the Budget
  - A. Chart of Accounts
  - B. Income Projections
    - 1. Assessment Income



2. Projected Delinquencies
3. Other Income
4. Special Assessments

C. Expense Projections

1. Administration
2. Taxes & licenses
3. Payroll
4. Utilities
5. Service contracts
6. Repair contracts
7. Staff supplies & equipment
8. Capital improvements
9. Reserve projects
10. Transfers to reserves

V. Reserve fund activity

VI. Worksheets

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II. Statutory warranties

III. Construction defects

IV. Bonds

V. Board transition

VI. Management transition

VII. Service and maintenance contracts

VIII. Documents and files

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X. Special considerations

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- B. For homeowner associations
- C. For communities that take years to fully build out

## **Ch. 13 – CCOC and the Mediation Process**

## **Ch. 14 - Owner and Association Resources and Links**

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- B. Maryland Homeowners Association Act
- C. Maryland Cooperative Housing Corporation Act
- D. Maryland Non-stock Corporation Act
- E. Maryland Contract Lien Act

### **II. Applicable County Codes**

- A. Montgomery County Code, Chapter 10B
- B. Common Ownership Communities
- C. Mediation Program

### **III. County Resources**

- A. Montgomery County Department of Housing and Community Affairs
- B. Division of Consumer Affairs
- C. Montgomery County Commission on Common Ownership Communities
- D. Housing Opportunities Commission for Montgomery County

### **IV. Government Resources Directory**

#### **A. Federal Resources**

- 1. Federal Courts
- 2. Federal Laws
- 3. Federal Agencies and Commissions

### **V. Maryland - Other Resources**

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#### **B. Maryland General Assembly**

- 1. Senate
- 2. House of Delegates
- 3. Department of Legislative Services

#### **C. Maryland Agencies**

#### **D. Maryland State Government Official Web Portal**

#### **E. Maryland Secretary of State**

#### **F. Office of the Attorney General**

#### **G. Maryland Department of Housing and Community Development**

## **Maintenance/Engineering**

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## **Ch. 1 – ASSOCIATION ORGANIZATION: GOVERNING STANDARDS AND DOCUMENTS**

### **I. Maryland Statutes and Montgomery County Code**

This chapter discusses the laws and recorded documents that determine the legal standing, authority, and activities of common ownership communities. These documents include:

- 1) Maryland Condominium Act (Real Property Article, Annotated Code of Maryland, Sections 11-101, et seq.);
- 2) Maryland Homeowners Association Act (Real Property Article, Annotated Code of Maryland, Sections 11B-101, et seq.);
- 3) Maryland Contract Lien Act (Real Property Article, Annotated Code of Maryland, Sections 14-201 to -206);
- 4) Relevant sections of the Corporations and Associations titles of the Annotated Code of Maryland; and
- 5) Chapters 10B, 11A and 24B of the Montgomery County Code.

This chapter also describes the (i) Declaration of Covenants, Conditions and Restrictions, (ii) Master Deeds, (iii) Articles of Incorporation, and (iv) the Bylaws, collectively referred to as the “governing documents.” State and County statutes provide the bases for establishing common ownership communities, which are also often referred to as community associations, planned residential developments, and/or common interest developments.

The management and governance of common ownership communities are outlined in the association’s governing documents. The Declaration, sometimes called the Declaration of Covenants, Conditions and Restrictions (CCRs), imposes architectural guidelines and use limitations on the exterior of the privately owned properties or residential units within the association. These controls are intended to provide uniform standards for the community and some protection of the property values. State laws and the governing documents jointly empower the association to adopt and enforce rules and regulations as the association deems pertinent to resolve problems and govern the everyday routines and activities within the community. This combination of laws, governing documents, and adopted policies and regulations makes each and every association a distinctly separate and unique entity.

The primary difference between a homeowners association and a condominium association is in the ownership of the common grounds and the common elements. In a homeowners association, the common grounds and facilities (if any) are owned in fee simple by the association as an entity; all members have a right to use and an obligation to fund the maintenance of the common grounds and common elements. In a condominium, each individual unit owner also owns an undivided interest in all common grounds, streets and parking, recreation facilities, utilities, and parts of the residential structure (*i.e.*, the roof and lobby), which are collectively known as the “common elements.” The condominium association, sometimes referred to as the Council of Unit Owners, typically, owns no part of the common elements.

In both types of property ownership, however, the association is legally responsible to maintain, repair, replace, and manage the common grounds/elements, and has the authority to adopt and enforce rules and regulations for the members’ use of the common grounds/elements. These differences are substantial enough to require separate statutes in the Annotated Code of Maryland. In certain cases, the Montgomery County Code provides further statutory authority to enforce association covenants, bylaws, rules and regulations, and/or to become involved in an association’s business, membership, or other internal matters. Beyond these State and County laws, the association’s self-governance takes place through its internal due-process procedure, alternative dispute resolution methods, or civil actions in court, which may be initiated either by the association or by a member.

Association membership, rights, and obligations are mandatory and automatic with the purchase of a property or residential unit subject to its governing documents. This mandate for association membership runs with the land, and automatically transfers to each new owner every time the property or unit is sold. This mandatory membership cannot be waived or voided by an owner, and is enforceable by law. This also assures each

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member's right to use the common facilities and grounds, and imposes upon each member an obligation to share in the common expense and responsibilities of governance. The association has the lawful authority to annually assess and collect fees for maintenance of the community and operation of the association; to enforce the covenants, conditions, and restrictions; and, if necessary and provided for in the governing documents, to levy monetary penalties or assessments for violations thereof.

#### A. Maryland Condominium Act

Anyone involved in the governance of a condominium must understand and be familiar with the Maryland Condominium Act, which is found within the Real Property Article of the Annotated Code of Maryland, Sections 11-101, et seq. This statute imposes specific limitations, restrictions, responsibilities and obligations that may not be included in the recorded documents. Among the more important provisions of the Condominium Act are the following:

Section 11-101. Definitions: The Condominium Act provides a common framework for specific terms relative to condominium governance. These include:

- › Board of directors (or ABoard=): the persons to whom some or all of the powers of the council of unit owners have been delegated;
- › Council of unit owners: the legal entity described in Section 11-109 of the Condominium Act;
- › Governing body: the council of unit owners, board of directors, or any committee of the council of unit owners or board of directors;
- › Unit owner: the person, or combination of persons, who hold legal title to a unit.

Section 11-102. Establishment of condominium regime: Identifies how and when a condominium officially is established, including conversions of an existing property to a condominium.

Section 11-103. Declaration: Identifies and provides the minimum components of a condominium declaration. These include, but are not limited to:

- › The name of the condominium, which must include the word "condominium," or Have the words "a condominium" immediately follow the name;
- › A general description of each unit, including its perimeters, location, and any other Data sufficient to identify it with reasonable certainty;
- › General common elements and limited common elements;
- › The percentage interest appurtenant to each unit (referring to Section 11-107. Percentage interests); and
- › Amending the Declaration, including what may and may not be amended, and the percentage of unit owner approval required for each.

**Note:** The statutory requirements to amend a condominium Declaration do not apply to the Board's authority to designate handicapped parking spaces in accordance to Section 11-109(d)(22).

Section 11-104. Bylaws: Identifies and provides the minimum components of the bylaws as the bases to govern administration of a condominium, which are to be recorded with the declaration. If the condominium is incorporated, the bylaws become the corporate bylaws.

#### B. Maryland Homeowners Association Act

Anyone involved in the governance of a homeowners association (as distinguished from a condominium or cooperative) must understand and be familiar with the Maryland Homeowners Association Act ("HOA Act"), which is found in the Real Property Article of the Annotated Code of Maryland, Sections 11B-101, et seq.

In a homeowners association, the land is subdivided into residential lots and common grounds. Each lot is privately owned, taxed, and assessed association dues whereas the common grounds and facilities are owned in the name of the association. The association is legally established and defined when the Declaration of Covenants, Conditions and Restrictions, an approved subdivision site plan, the Deed of Dedication, and (occasionally) the Bylaws are recorded in the Homeowners Association Depository (a facility in the Office of the Clerk of the Court for the County where the Association is located). These documents may contain restrictive or permissive easements,

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covenants or other regulations that apply to and govern the use of all lots included in the association. Recordation of these approved documents legally defines and establishes the entity and the mandate for association membership. At this moment of the association's the developer/declarant is the only member and, thus, possesses full voting control of the association until the first property is sold. Thereafter, the owner membership and owner control grows with the purchase of each lot or unit. Usually, the governing documents establish different classes of membership such that the developer has more votes per unsold lot or unit than the new owners. This assures that the developer maintains voting control of the association until sales reach the requisite percentage of ownership to assume control of the association and its operations. Eventually, all of the properties or units in the association, together with the voting rights, are sold and the control and operation of the association is taken over by the owners themselves.

Among the more important provisions of the HOA Act are the following:

Section 11B-101. Definitions: The Condominium Act provides a common framework for specific terms relative to condominium governance. These include:

- › Common areas: property which is owned or leased by a homeowners association;
- › Declaration: the instrument recorded in the land records of the county in which the association is located that creates the authority for a homeowners association to impose on lots, or on the owners or occupants of lots, or on another homeowners association, condominium, or cooperative housing corporation any mandatory fee in connection with the provision of services or otherwise for the benefit of some or all of the lots, the owners or occupants of lots, or the common areas;
- › Depository; homeowners association depository: the document file created by the clerk of the court of each county and the City of Baltimore where a homeowners association may periodically deposit information as require by this title;
- › Governing body: the homeowners association, board of directors, or other entity established to govern the development;
- › Homeowners association: a person having the authority to enforce the provisions of a declaration, and includes an incorporated or unincorporated association;
- › Recorded covenants and restrictions: any instrument of writing which is recorded in the land records of the jurisdiction within which a lot is located, and which instrument governs or otherwise legally restricts the use of such lot.

Section 11B-104. Building code or zoning laws, ordinances, and regulations to be given full force and effect; local laws, ordinances, or regulations: Provides full force and effect to homeowners associations of all laws, ordinances, and regulations concerning building codes or zoning.

Section 11B-111. Meetings of homeowners association or its governing body: Requires all meetings of homeowners associations, including boards of directors or other governing body, or association committees, to be open to all members of the homeowners association or their agents; and requires reasonable notice to be given to all members of the association of all regularly scheduled open meetings of the homeowners association.

## C. Montgomery County Code [to be added?]

### II. Governing Documents

A. The Declaration of Covenants, Conditions and Restrictions: "CCRs" provide the legal basis for preserving the developer's approved plan for the residential and common properties in a development, and establishes the rights and obligations of the owners and their association. The declaration/CCRs typically include a:

1. Description of: each parcel, lot or property subject to the association membership and its covenants conditions and restrictions;
  - > Types of housing permitted;
  - > Requirements for the property owners' association to be responsible for the maintenance and improvement of common property;
  - > Definition of membership requirements and obligations; provision for a governing body; and assigned voting rights of each type of association member;
  - > Provision for the annual assessment of each lot to raise the funds to maintain the common areas, provide community services; and operate the association;
  - > Requirement for prior association approval for all exterior changes or additions to any private lot or structure; and provisions for association enforcement; and,

- > Provision for members' access and use of the common grounds and facilities.
- 2. Plats
  - a. Percentages of ownership interest
- 3. Defining membership requirements and obligations
- 4. Assigning/Defining voting rights of each type of association member
- 5. Covenants, Conditions and Restrictions
- 6. Method for amendment

**Note:** Any amendment to the Declaration must be officially ratified by a vote of the owners. Any amendment must be consistent with the state law and current zoning requirements. Any amendment to a recorded document, no matter how small or insignificant, must also be recorded in the Depository to supercede the former record and to become legally enforceable.

## B. Bylaws

The bylaws of a community association are administrative rules, guidelines and requirements that are based upon and support the declaration and, where applicable, the Articles of Incorporation. The bylaws detail the authority and responsibility of the board, and must be recorded in the County Land Records for condominiums, and in the Depository for homeowners associations. Effectively, the bylaws are the association's operational and procedural manual.

In cases of conflict, the bylaws have higher standing than adopted rules and regulations or policy resolutions of the association. Typically, bylaws specify:

- › Requirements for the annual membership meeting, for special meetings, and the notices required prior to these meetings;
- › Rules for the conduct of meetings, *i.e.*, the agenda, the order of business, quorum requirements, vote requirements for passage of different types of business items, etc;
- › The number of directors, the length of their terms of office, methods of election and recall; and notice for and number of board meetings;
- › The association's officers, their powers and duties, and the method and frequency of their election;
- › Committees that may be established to advise and assist in the management of the association;
- › The method for amending the bylaws and other governing documents;
- › Bonding and insurance requirements;
- › Enforcement of the declaration, bylaws, rules and regulations;
- › Maintenance of association properties;
- › Establishment of sound financial procedures, financial reports and the budget; maintenance of the books and records, assessment levels, and collection of assessments;
- › Purchase of required hazard and liability insurance;
- › Employment of staff, and definition of their duties; and
- › Appointment of committee members and supervision of their duties.

The bylaws often specify members' rights, including the right to vote in person or by proxy, the right to inspect the association books and records, the right to receive proper notice of meetings and assessment levels. The bylaws may also reiterate the members' responsibilities to pay both the annual and any special assessment, to follow restrictions outlined in the declaration and bylaws, and to abide by the rules and regulations established by the board of directors.

- 1. Meeting requirements; quorum
- 2. Number of directors, the length of their terms of office, methods of election and recall
- 3. Association officers, their powers and duties, and the method and frequency of their election

4. Employ or contract (and dismiss and replace) agents and employees for condominium management services
  5. Committees
  6. Method for amendments; supermajority
  7. Required insurance
  8. Enforcement of the declaration, bylaws, rules and regulations
  9. Maintenance of general common elements
  10. Financial procedures, including budgeting; maintaining books and records, and collecting assessments
  11. Members= rights and responsibilities, including, *e.g.*,
    - a. voting procedures;
    - b. the right to inspect the association books and records;
    - c. proper notice of meetings and assessment levels;
    - d. payment of annual and special assessment;
    - e. following restrictions outlined in the declaration, bylaws, and rules and regulations established by the board of directors.
- C. Master Deeds
- D. Articles of Incorporation
- E. Rules
1. Method for adoption (x-ref. Condo Act, etc.)
  2. Bases for rules in governing documents
  3. Architectural guidelines and use limitations providing uniform standards for the community and some protection of the property values.

### III. Disclosure Requirements

Because of the special scheme of property ownership and authority found in community associations, prospective purchasers need to know the various rights, responsibilities and authorities of the association and its members before they buy. They also need to know that the property is in good standing with the association in regard to its assessment account and its compliance with the covenants, conditions and restrictions of the governing documents. To accomplish this, the Condominium and Homeowners Association Acts require the seller to provide an association-prepared package to the purchaser that discloses that the property is located in an association subject to all provisions and requirements of the respective Acts.

The association may impose and collect a charge reflecting the actual cost of the preparation of the disclosure packet. The association is legally bound by its statements in the packet regarding (1) status of the assessment account and (2) violations of architectural guidelines on the property. If the association fails to provide the packet on time, it will likely be unable to collect delinquent assessments attributable to the seller.



## **Ch. 2 - Building Community**

### **A. The Owner/Leader Perspective**

- I. Building & Providing Leadership
  - A. Understanding the role of the Board members as community leaders and public servants, not dictators
  - B. Developing and utilizing a committee system/structure
  - C. Developing a pool of community volunteers as future community leaders
- II. Nurturing Relationships
  - A. Expanding beyond the concept of a Board that is closed circle or a 'clique' of close friends
  - B. Positively connecting between homeowners and community leadership (Board, committees, and management)
- III. Educating Residents
  - A. Educating Board and committee members, and other volunteers about the community association concept
  - B. Educating homeowners about the community association concept
- IV. Be Reasonable
  - A. Reviewing community CC&Rs, rules, etc., for logic, sensibility and soundness
  - B. Is the letter of the law necessary, or does it need to be changed?
- V. Practicing Due Process
  - A. Providing homeowners with a fair hearing
  - B. Providing homeowners with a right of appeal before imposing fines or other Apunishment@

- C. Understanding the requirements of the Maryland Condominium Act, Maryland Homeowners Association Act, and Montgomery County Code VI. Encouraging Consensus
  - A. Identifying controversial issues and engaging in interactive communication with the community
  - B. Seeking community input prior to controversial decisions by the Board
    - 1. X-Reference to statutory requirements; *e.g.*, required input from homeowners before budget or rules adoption
    - 2. Know your governing documents and requirements is the same for homeowner vote prior to certain decisions
  - C. Seek to understand rationale for minority views
- VII. Preventing & Resolving Conflicts
- A. Alternative Dispute Resolution (ADR)
    - 1. Mediation
    - 2. Arbitration
  - B. Dealing with the community gadfly/difficult personalities
- VIII. Positive Reinforcement for Volunteer Efforts
- A. Empower volunteers
  - B. Public appreciation of volunteers

## **Ch. 3 - BOARD, ANNUAL AND SPECIAL MEETINGS**

### **I. ANNUAL AND SPECIAL MEETINGS OF OWNERS**

The democratic process is alive and well in association meetings across our nation. However, the democratic process in associations requires order and rules of procedure and behavior so that boards of directors and the owners can work together to preserve, protect and enhance the value of the property and maintain a strong sense of community.

#### **Annual Meetings**

Typically, the administrative document for the association (usually the bylaws) sets forth criteria for the annual meeting, including notice, quorum, voting, and proxy procedures. Often, the bylaws state that the annual meeting is held to elect directors and to conduct such other business as may properly be brought before the meeting.

Other business may include, by way of example and not limitation, the presentation of officer and committee reports, approval of the annual budget (if owner approval is required), voting on special assessments (if required), and voting on proposed amendments to the governing documents. Unless otherwise set forth specifically in the documents, any business which may appropriately come before the body can be entertained and, if needed, voted upon. It also provides a forum for discussions on various aspects of association life and for non-binding, straw votes of the owners that can be used by the board as a tool to determine constituent interests.

However, the annual meeting is not a vehicle that may be used to expand the power of the owners beyond what is authorized in the governing documents! Most powers of the association are delegated to the duly elected board of directors by the governing documents. This is done purposely to create a representative form of governance in which the duly elected directors assume a duty of loyalty and due care to the association. Implied in this duty is an obligation to become educated as to the needs of the association and the actions to be taken which will be in the best interest of the association. The owners as a whole cannot “take back” powers so delegated without amending the governing documents.

#### **Special Meetings**

Most bylaws do not allow the owners to take any action at a special meeting that is not specifically indicated in the meeting notice, even if a majority of all owners is present. The reason is simple: Owners will base their decision whether to attend the meeting upon the purpose stated in the notice. Conducting business that is not indicated in the notice disenfranchises those who did not attend based upon what they were told would be the subject of the meeting. Attendance by a majority does not matter because those not attending may have changed the outcome had they known the true purpose and had an opportunity to present an alternative case and persuade others to their viewpoint.

Take care when drafting special meeting notices. Imprecise language or an unclear purpose can render the meeting invalid. For example, calling a special meeting “to discuss the removal of one or more directors” has two potentially fatal flaws. The first is the phrase “to discuss,” which limits the meeting merely to discussion of the removal. No vote on the removal can be taken.

The second is the phrase “one or more directors.” Because most bylaws require the association to notify any director of his or her proposed removal, the association must provide such notice to each before taking action. Use of the phrase “one or more directors” is imprecise, thus problematical. However, the bylaw requirement would not pose a problem if the notice proposed the removal of all directors.

Special meetings differ in one other significant respect from annual meetings. Bylaws usually allow a group of owners to call a special meeting. To call a special meeting, a minimum number of members must sign a petition and present it to the board president or secretary. The petition must precisely state the purpose of the meeting. The president or secretary then calls the meeting for the purpose contained in the petition.

## **A. NOTICE OF MEETINGS**

### Distributing Meeting Notices

Notice of an annual or special meeting is an important procedural element of a successful meeting. How, when, and to whom notice must be given is governed by the bylaws and, for condominiums, state law. When notifying owners of a meeting, the association must follow certain guidelines.

### Whom Do You Notify?

Virtually all bylaws and state statutes require the association to send a notice to each owner. This means that every owner of record must receive notice, even if the owner is ineligible to vote at the meeting. This can also be beneficial to the collection of assessments process, as notice of a meeting is a good way to encourage all owners to clear a delinquency so that they are eligible to vote at the meeting or stand for election to the board. Note that sending notice to all owners also means that each owner or co-owner of a unit or lot whose identity is known to the association must receive notice. Accordingly, if a unit is owned by husband and wife or other multiple residents of the unit, a single notice should be addressed to both at the unit address. If there are multiple non-resident owners, notice should be sent to each owner at the address of record with the association.

The association has an affirmative duty to keep an accurate roster of owners and their current addresses. Prudent HOA bylaws and the Condominium Act itself require owners to keep the association apprised of their identity and address, and deny the right to vote to those who do not. The association is responsible for sending notice to all persons who are listed on its roster as owners. If owners fail to receive notice because they did not notify the association of their ownership or current address, the association is not at fault.

### What Address Should You Use?

Notice should always be sent to the address of the unit or lot unless the owner has specifically designated another address of record. If mail is returned from an alternate address of record with no forwarding address, the association should ask the renter or resident for the owner’s current address. If the unit is vacant or the resident will not divulge the address, the association has little choice but to send the notice to the last known address of record AND to the owner at the unit address.

### Delivery of Notice

State statutes and association governing documents often define acceptable means of delivering official meeting notices. Delivery by first-class mail, postage prepaid, is almost always permissible. However, some older documents require associations to deliver notices by registered or certified mail. If so, the association should consider amending the documents to delete that provision. Realistically, certified mail delivery is less effective because many people routinely decline it. First-class mail, on the other hand, will be left in the owner's mailbox and does not require the owner to be home. Moreover, the law in every jurisdiction establishes a presumption of delivery if the notice was sent by first-class mail.

Other forms of delivery are also acceptable. Documents often allow the association to deliver notices by hand. Some associations prefer this method because it saves postage and seems more personal. This method can pose problems, however. Postal regulations forbid the placement of anything other than official mail items bearing postage that have been delivered by the Postal Service in a person's mailbox. Postal regulations also prohibit posting or affixing notices to the exterior of mailboxes or cluster boxes, although additional housing around cluster boxes may itself be used for posting notice.

Some associations hand deliver notices by placing them on the door knob, stoop, or threshold. Some slide them under the door or wedge them between the door and the frame. However, should the notice be blown away, removed, mutilated, or destroyed, the affected owner(s) may claim that actual notice was not given which may invalidate the meeting. Even an established pattern or practice of delivering notice does not necessarily negate the effect of alleged non-delivery. Hand delivery is truly effective only if one person actually places the notice in the recipient's hand, and even then certification of delivery may be required.

Some associations deliver notices by posting them on bulletin boards, in common hallways, on entryway doors, and in elevators. If an association has established a pattern and practice of delivering notice in this manner, that evidence would be admissible in court and most likely would be persuasive if someone challenged the method of giving notice.

Unless the bylaws specifically allow for posting or the practice is already well-established, it is better to use another method of delivery. Again, owners can claim that the notice was not seen or that they were out of town during that time. Unless the association is entitled to the presumption of delivery that attaches to notices sent by first-class mail, owners can claim that they did not receive the notice and challenge the meeting.

A few associations attempt to provide meeting notice via the association newsletter. An association that uses this method should mail the newsletter and should either put the notice on the front page or put a bold-faced statement on the front page that the meeting notice is inside. As with posting, this mode of delivery is advisable only if it is an established practice and if it is common knowledge among the owners that notice will always be made in this manner.

If delivery of notice is made by any means other than by hand or through the mail, it is better to use more than one method. A notice challenge is more likely to be defeated if the association can show that notice was, for example, both posted and put in the newsletter.

### Timing of Notice

State statutes and association bylaws dictate the time frame in which associations must deliver meeting notices. Any conflict between the notice period in the bylaws and that required by statute should be resolved in favor of the statute. Thus, if the bylaws state that notice of meetings must be given no less than 10 or more than 60 days prior to the meeting, and the statute requires that notice be a minimum of 15 days prior to the meeting, the association will be obliged to give notice to the owners no less than 15 days and no more than 60 days prior to the meeting.

Most statutes and many bylaws provide only for a minimum time for notice of both annual and special meetings, although some bylaws provide a maximum time for notice of special meetings. However, the establishment of a maximum time limit can be important as well, since owners may forget the date or lose the notice if it is delivered too far in advance. As a result, the association may fail to achieve a quorum.

The lack of a maximum time limit can also lead to an abuse of power by an incumbent administration, especially in regard to special meetings that must be called pursuant to an owner petition. For example, a group of owners files a petition requesting a special meeting to remove all of the directors because they have indicated that they will allow an important contract to automatically renew. The owners do not want the contract renewed and know that notice of termination must be given to the contractor within 45 days to prevent the automatic renewal. The board, also aware of the timing, sets the date of the special meeting for the day after automatic renewal, knowing that the bylaws do not set a maximum time limit. Because of this gap in the bylaws, the board will probably succeed in its scheme, since the owners would have to file suit to move the meeting time forward. Most likely, the contract renewal date will pass and the owners' effort to remove the directors will fail. If, in this instance, there had been an outside time limit that was violated by the board, the owners might successfully challenge the contract, even after renewal.

### Notice to Mortgagees

Association governing documents usually specify whether notice of an annual or special meeting must be sent to the individuals or lending institutions holding first deeds of trust on the units or lots: the mortgagees. Generally, the documents require notice to mortgagees only when they are affected by something taking place at the meeting. The most common example is a meeting that is called to vote on proposed amendments to the governing documents.

## **C. QUORUM**

### Obtaining a Quorum

The term quorum refers to the minimum number of owners who must be present at a meeting, in person or by proxy, before business can be validly transacted. The number of members needed to constitute a quorum is often governed by statute. The statute will always control if it conflicts with documents provisions. The best quorum provision to insert in the documents is one that allows it to be reduced by statute and provides that a group of owners cannot try to sabotage a meeting by leaving just before a vote they think they will lose, thus rendering the vote invalid because a quorum was not present at that time:

**A quorum is deemed present throughout any meeting of the Association if persons entitled**

**to cast twenty-five percent (25%) (or such lesser percentage as may be provided by the Act) of the total authorized votes are present in person or by proxy at the beginning of the meeting.**

Governing documents often require a majority of the votes (sometimes expressed as 51 percent) for quorum. Most practitioners now regard that number as too high. Many statutes and newer documents allow for a lesser number of votes to constitute a quorum. The quorum should be as low as possible so that the association can conduct its business. Low quorums do not discourage high attendance, but the association must be given every opportunity to have an official meeting and conduct necessary business—even if a great percentage of owners choose not to attend.

#### Adjournment for Lack of Quorum

Most documents contain a procedure for adjourning a meeting due to a lack of quorum. Generally, the owners who are present in person or by proxy must obtain a majority vote to adjourn and reconvene at a later date even though the meeting was not officially constituted because a quorum was not present.

Often, restrictions state that the second meeting cannot take place within 48 hours of the adjournment so association members have time to convince others to attend. But it is not uncommon for fewer residents to attend the adjourned meeting than the first meeting. For this reason, the chairperson should ask everyone attending the first meeting to execute a proxy before leaving. Unexpected events may prevent owners who planned to attend the adjourned meeting from arriving. If the owner finds that she or he IS able to attend after all, any proxy given is revocable by the owner's attendance at the adjourned meeting.

#### Failure to Achieve Quorum

Maryland condominiums and homeowners associations should never fail to achieve quorum because the legislature has enacted provisions that enable each to hold an adjourned meeting at which the owners attending in person or by proxy automatically constitute a legal quorum despite the stated quorum provision in the governing documents.

For condominiums, Section 11-109 of the Maryland Condominium Act has been revised in July, 2003 and provides that an additional (second) meeting of the council of unit owners may be called if a quorum was not present at the first meeting, so long as the following criteria are met:

1. Notice of the initial meeting stated that the Section 11-109 procedures would be used if a quorum was not achieved.
2. A majority of those owners present in person or by proxy vote to call for the additional meeting.
3. Notice of the additional meeting is mailed to all owners at least fifteen (15) days prior to the additional meeting.

If the criteria are met, those persons who attend the additional meeting in person or by proxy, no matter how few, automatically constitute a quorum and any business that might have been conducted at the original meeting can be conducted at the additional meeting.

NOTE: The reduced quorum provision of Section 11-109 cannot be used to reduce the number of votes necessary to amend the declaration or bylaws or to reduce the vote specified in the documents for a certain action. For example, if the bylaws require that a majority of all owners is required to approve a special assessment, that vote must still be achieved before the special assessment may be deemed to have passed.

For homeowners associations, Section 5-206 of the Corporations and Associations Article, Maryland Annotated Code, makes similar provision for an additional meeting. The only difference is that notice of the additional meeting must be advertised in a newspaper of local circulation.

NOTE: Section 5-206 does not require that notice of the second meeting be mailed to homeowners. Nonetheless, it is recommended that notice be sent to all owners by mail so that they are apprised of the additional meeting and can attend.

## **D. CONDUCTING THE MEETING**

### Parliamentary Procedure

Most association documents require the board to use parliamentary procedure at annual and special meetings. Though the structure of parliamentary procedure often aids a meeting, as with many good things, parliamentary procedure can be overdone. Most documents that require the use of parliamentary procedure specifically refer to Robert's Rules of Order, which is available in a variety of forms and editions. Unless the documents specify a form and edition, the association should choose a version of Robert's that it likes and stick with it. This measure will provide meetings with a degree of continuity from year to year. Because associations rarely need the complicated rules that are contained in complete editions of Robert's, abbreviated editions that focus on the basics can be easier to use and understand.

### Order of Business

Many sets of governing documents contain a specified order of business to be followed at the annual meeting (and, sometimes, even any special meetings). The annual meeting order of business called for in these documents is often similar to the one that follows:

- Call to Order
- Roll Call (usually obviated by the check-in process)
- Verification of Quorum
- Proof of Notice (of Meeting)
- Reading and Approval of the Minutes of the Previous Meeting
- Report of the President
- Report of the Treasurer
- Reports of Other Officers
- Committee Reports
- Old Business
- New Business
- Appointment of Inspectors of Election
- Candidate Forum
- Election



## Adjournment

If the order of business is set by the bylaws, most associations choose to follow it to the letter. However, there are sometimes two circumstances when following this order of business detracts from the efficiency and brevity of the meeting: (1) when the calculation of a quorum is complicated and takes quite some time, and (2) waiting for the counting of votes and the announcement of election results. The first problem is easily resolved by the president or other officers going out of order and making their reports while quorum is being tabulated. It is a simple matter to inform the owners that the reports are being made in the hope that a quorum will be had and the meeting can later be officially opened. Because the meeting cannot be officially opened until a quorum is confirmed, it is not appropriate to entertain a motion to revise the order of business, but the reports can be made on an unofficial basis and then later adopted by the body as the official reports once the meeting is opened. If the meeting cannot be opened for lack of quorum, those present will have had the benefit of receiving valuable information and no harm is done.

Because calculating the results of an election can also take some time, it may be appropriate to entertain a motion to revise the order of business by moving the election up so that it is conducted before reports and other routine business. Having done so, the results can be calculated while other business is being conducted so that the winners can be announced before the meeting concludes. The only potential problem with this change in order of business can come when the body knows that a controversial issue will be brought up under old or new business. In that event, it may be difficult to get volunteers to count votes and act as inspectors of election because they want to be present for the discussion on the hot topic. Of course, that need can also be accommodated by being flexible and only allowing the reports to be made and business other than the hot topic to be discussed during the counting of votes, reserving discussion on the hot topic until after all are again present.

The order of business for *special meetings* is typically:

- Call to Order
- Roll Call (usually obviated by the check-in process)
- Verification of Quorum
- Proof of Notice (of Meeting)
- Business Called for in the Notice of Meeting
- Adjournment

## II. ELECTIONS

### Organizing an Election

Conducting the election itself should be a simple matter, and there is no need to complicate it with undue procedures or embellishments. It is a good idea to conduct the election as early in the meeting as possible so the results can be tabulated as the meeting progresses. It also can be politic to do so because some meetings seem to ferment until the election occurs, especially if the election is hotly contested. If the documents set an agenda where the election occurs last, it is easy enough to entertain a motion to revise the agenda.

### Candidate Forum

It is important that all candidates for the board of directors have an opportunity to meet the owners and tell them their qualifications and platforms. Unfortunately, most governing documents are completely silent on this issue. It then becomes incumbent upon the current board of directors to set candidate forum rules for the election.

Some associations go so far as to have one or more candidate forum meetings before the annual meeting at which the candidates get a specified amount of time to make a presentation and the owners then have a question and answer period in which to further explore the candidates' qualifications and philosophies. Many associations publish candidate resumes prior to the annual meeting. However, even if all of these methods are employed, some version of the candidate forum should also be conducted at the time of the election so that voters not attending other meetings or reviewing the written materials will have some minimal introduction to the candidates. Speaking time limits and question and answer period time limits should be set before the meeting and announced at the beginning of the forum.

Unless specified in the documents, there is no right or wrong way to conduct a candidate forum: the important thing is to foster communication between the owners and the candidates so that the owners have an opportunity to elect those who best represent their viewpoints.

### Inspectors of Election

Many documents call for the appointment of inspectors of election from the owners present at the meeting. Even if the documents do not require such inspectors, it can be prudent for the chairperson to appoint them so the election can be certified as legitimate. Three people should be appointed, and at least one of them should be from the opposition if the group is divided into factions. Naturally, no one should be an inspector who has an interest in the election results, such as candidates, candidates' spouses, current officers, or directors. The inspectors should be neutral and fair.

Inspectors can be given the task of merely observing, or they can help with the process. In some associations, the inspectors conduct the entire ballot collection and vote tabulation process. The chairperson should describe the inspectors' function in detail at the meeting before making appointments. The inspectors should be required to certify, by signature, that the election was conducted fairly and that the results were accurate. The election results and the inspectors' certification should be kept among the association records for at least three years.

### Taking the Vote

The next step is taking the vote. Attendees should be given ample time to mark their ballots and fold or seal them for collection. Some associations have the inspectors take the ballots from each person or from the person at the end of each row. Others require voters to deposit ballots in a ballot box, which is passed around or found at a particular location. The process should be quick and the security of the ballots should be protected, especially if it is a secret vote.

### Tabulating the Vote

Several methods of vote tabulation are available to associations. These methods range from basic computation by hand, to sophisticated calculators, to computerized tabulation using bar

codes. The League of Women Voters will, for a contribution, attend the meeting, count ballots and proxies, and certify results. No method is right or wrong. All that matters is that the vote is accurately counted.

The association should set procedures beforehand and make sure the individuals involved understand their tasks no matter what method it uses. Advance preparation is needed to ensure accuracy and to project the people involved as effectual. It also can be important to have tally sheets prepared in a format similar to that used for counting.

More than one person should be involved in the counting, and the job should be split among each person. For example, one person could be assigned all of the proxies and ballots that are filed by owners with a certain percentage interest. Once the number of votes for each candidate is determined, that total need only be multiplied by the percentage interest of that category. These totals are then recorded on the prepared tally sheet for that percentage interest and given to the person who will receive all of the tally sheets for each percentage interest. It is then a simple matter of adding the subtotals from each percentage interest to determine the total vote for each candidate.

Contemporary computer technology offers associations new and interesting ways to tabulate election results. Some companies will, for a fee, bar code all ballots and proxies. Associations that use this method will have election results available within minutes of the vote.

Software packages are now available that allow associations and management companies to provide identical services. One need only purchase the software, load it on a PC-compatible computer, and rent or buy a bar-code reader (or enter coded information by hand). This technology is a great time-saver and allows associations to achieve a new level of accuracy.

#### Majority or Plurality

In many elections, especially those where there are more candidates than open positions, candidates with the highest number of votes may not earn the majority of the votes. Such a result will not create problems for an association if its documents provide that the candidate with the greatest number of votes (the plurality) will win the election. If the documents are silent on this issue, and state that all issues arising at the meeting should be decided by a majority, the association may face a question about how many votes a candidate needs to be elected.

If an association adopts a conservative interpretation that requires a candidate to earn a majority vote to be elected, it may need to hold an indeterminate number of run-off elections before all positions are filled. For example, if there are five candidates for three positions and the candidates receive 42, 27, 15, 11, and 5 percent of the vote, respectively, none of them have been elected. The association would then be required to drop the lowest candidate and try again. This might happen several times before three candidates are elected by majority vote.

It is better to view the ELECTION as the main issue. As long as the ELECTION is decided by a majority vote, candidates should be elected based upon those receiving the greatest number of votes even if that is a plurality. It is difficult to conceive that association developers or their attorneys ever intended to saddle associations with the cumbersome process that a true majority vote requirement would entail. An association with documentary language that requires a

majority vote should ask its attorney for a formal opinion letter regarding the actual vote necessary for each successful candidate.

### Election Materials

Associations should never favor a particular candidate when preparing election materials with association funds. The Condominium Act requires condominiums to list candidates alphabetically and to show no preference. Though this rule seems simple, many wonder if the indication that a candidate is an incumbent is a statement of preference? From a practical standpoint, being an incumbent may be an asset or a liability, depending upon how the current administration is regarded by the voter. The best bet is to not indicate incumbency. Most owners are going to know who is an incumbent. It should be left to the candidates whether or not to emphasize their incumbency in the candidate forum or in prepared written materials.

### Voting by Ballot

All votes except those on minor or procedural issues should be recorded on a written ballot. A written ballot allows for continuity, as the vote of those owners filing directed proxies will be in writing. The ballot also safeguards the integrity of the vote, as a permanent record is available if the vote is challenged. Keep ballots for at least one year or, preferably, for three years.

A written ballot also can have a positive psychological effect. People seem to feel like they are doing something positive and official when casting ballots, as opposed to merely raising their hands. Filling out a ballot also makes people feel like the association is being efficiently run or managed. Moreover, putting their vote in writing usually makes people reflect or deliberate on their choice a little longer.

### Secret Ballot

Many associations have either a tradition or a requirement to hold all votes in confidence. Implementing a procedural system that ensures the secrecy of a vote is not difficult, but it requires planning. A secret vote must be done by written instrument: it is impossible to keep one's position private if the vote is taken by a show of hands or by ayes and nays. The simplest system for those who will be voting in person or by proxy is to distribute ballots at the registration table. It is easy to check voters in, verify their status, and give them a blank ballot that is marked with the percentage interest of their vote. Then the voters merely place the ballot in the ballot box after voting. The ballot only contains the percentage interest voted and the vote itself, not the name and address of the owner.

If the secret vote includes mail-in votes, either directed proxies or absentee ballots, the best system involves dual envelopes. The ballot or proxy stating the percentage interest is mailed to the owner along with two envelopes. One envelope is used as the outer envelope and the other as the inner envelope. Owners cast their vote on the form and place it in the inner envelope, which is blank. That envelope is placed in the outer envelope, which contains the owners name and the unit or lot number. The package is mailed or put into a ballot box located on the property. The outer envelope is used for registration purposes, then opened, emptied, and discarded. The inner envelope is placed in the ballot box for counting at the same time that the ballots of those at the meeting in person are counted (unless, as will be discussed below, mail-in votes are counted before the meeting to expedite the tabulation process). As long as the outer and inner envelopes are separated as described and no identifiers are on the ballot or proxy,

secrecy will be maintained.

### Ballot Form and Content

The ballot form need not be any more complicated than the proxy form. It only needs to set forth clearly what or whom the owners are voting for or against.

### Election Records

The ballots, proxies and tabulation sheets used during the election are the official election records of the association. These records should be maintained by the association for the longest term granted in the election. So, for example, if one or more directors were elected for a three year term, the records should be kept for three years. If the entire board is elected each year for a one year term, records need only be kept for that year.

Because the board of directors conducts virtually all of the business of the association, the integrity of an election is extremely important. Any director seated in error is not properly elected, and any decisions of a board containing one or more such directors are subject to challenge. For this reason, all elections should be conducted in strict accordance with the governing documents and Maryland law and records vouchsafing the results should be kept in order to answer any challenge.

## PROXIES

### Voting by Proxy

A proxy is the written authorization that allows one person to appoint another to vote on his or her behalf. The term “proxy” refers to the written instrument, while “proxy holder” refers to the person who is designated to vote for another at an annual or special meeting. The “proxy giver” is the person who authorizes another to vote on his or her behalf. The use of proxies in community associations is usually determined by Maryland law, the association’s governing documents, or both.

### General Proxies

The most common type of proxy used in community associations is the general proxy. A general proxy allows the holder to vote at a meeting. Blanket general proxies allow the holder to vote on any matter that comes before the owners during the life of the proxy. If the proxy giver executes a general proxy, the proxy holder is authorized to vote as if he or she were the proxy giver.

### Directed Proxies

Directed proxies bind the proxy holder to specific terms, allowing the proxy giver to control the vote. The directed proxy is, in effect, an absentee ballot, which means that the proxy holder is little more than a courier who is entrusted with recording a vote. The Condominium Act requires condominiums to use directed proxies for the election of directors. The Homeowners Association Act does not have a similar provision, but using directed proxies helps control electioneering and election fraud.

### Other Proxy Limitations

The right to vote by proxy relates to the right of an individual to vote. Statutes do not guarantee

anyone the right to be a proxy holder. Accordingly, limitations placed on the proxy holder cannot abridge any right.

Limiting the number of proxies that any single individual may hold can thwart the assertive person who otherwise would show up at the meeting with the election in the bag. Such a limitation should include board members and management. Unfortunately, these individuals often are allowed an unlimited number of proxy votes because policy drafters assume they will vote in a neutral manner.

It is quite common for proxy holders to be limited to other owners. It makes sense that the proxy, especially if it is a general proxy, be voted by someone who has the same interest in the property as the proxy giver. By the same token, outsiders would normally have little interest in the association's affairs and little knowledge upon which to base intelligent decisions. This limitation, then, also increases the integrity of an election or vote.

Some associations allow tenants and mortgagees to vote by proxy. Each of these parties should be concerned, for example, to see that the association is managed well and to vote accordingly. The interest of tenants and mortgagees is recognized by law in some jurisdictions. For example, in Maryland, time limits placed on proxies may be waived when the holder is a tenant or a mortgagee.

The association secretary may be the repository for proxies that are cast by the proxy giver or that are used only to establish quorum. The secretary is normally responsible for controlling the association's books and records, receiving mail and service of process, and certifying votes or elections. The owners should be able to rely upon the integrity of the secretary and of the office to carry out this task.

#### Proxy Form and Content

Some governing documents contain specific requirements for proxy form and content. Most, however, are silent as are the Condominium Act and the HOA Act. A proxy need not be a sophisticated legal instrument full of incomprehensible language. The purpose of a proxy is to assign a vote from one person to another. It is sufficient, then, if the instrument identifies the proxy giver (and his or her unit or lot, if required), the proxy holder, the meeting or vote for which the assignment is intended (including the date, time, and place, if necessary), the date of the proxy, and the signature of the proxy giver. If a witness or notarization is required, those blanks must be provided. If the proxy is directed, the information and blanks necessary for the proxy givers to direct their vote must be provided. It may be necessary to provide written instructions for proper execution of the proxy. These instructions can be included either on the proxy form or on a separate sheet.

### **III. BOARD MEETINGS**

#### Notice of Board Meetings

Meetings of the board of directors are official meetings of the association and must be treated accordingly. In fact, more official business of the association occurs at board meetings than at owner meetings. This is so because most of the powers and duties of the association are specifically delegated to the board in the governing documents. Typically, the only powers

reserved to the owners are the powers to elect and remove directors, amend the governing documents and, sometimes, approve special assessments. Otherwise, the board is tasked with maintaining the property, hiring and firing personnel and contractors, keeping the books and records, developing and enforcing rules, preparing the budget and setting the annual assessment, formulating policies and procedures, and complying with local, state and federal laws, ordinances and regulations. Except for emergencies, all of these things are done by the board at its meetings.

The nature and timing of the notice to board members is usually controlled by the documents or Maryland law. Many older documents require that notice be delivered via U.S. Mail three to five days before the meeting. Others are more flexible, allowing the board members to determine for themselves how and when they should receive notice. Many boards set the date for the next meeting before adjourning the current one, thereby giving all present notice at that time. Many others set regular monthly meetings for the same place, day and time (third Tuesday, 7:00 o'clock, p.m., in the clubhouse) so that it is only necessary to give notice of regular board meetings once a year.

Whatever method is employed (including email, facsimile and telephone), the form of the notice must be permitted under the documents and each director must receive notice in a timely manner. If no method or time is set by the documents or statute, the board should set its own policy so that there can be no dispute concerning whether notice was properly made.

Maryland now has what is generally known as a “sunshine” law, a law that requires board meetings to be open to all members of the association unless the subject matter of the meeting falls within certain categories for which closed or “executive session” meetings can be held. (See below.) A meeting cannot be deemed open to the owners unless they have notice, but the statute and many documents are silent as to how and when notice of board meetings must be given to them. If so, owners should receive the same notice as directors. Because giving monthly notice to all owners can be time consuming and costly, many associations have opted for one annual notice of pre-set monthly board meetings.

If board meetings are not pre-set, then owners will have to be given notice each month. This can be done by mailing notice to each owner in a timely fashion or by newsletter or by posting or by hand delivery. Email delivery is not appropriate unless the board can verify an email address for each owner. The same is true for posting on a web site. Until such time as the vagaries of electronic communication are a thing of the past, the best and most challenge-proof method of delivery is via the mail.

### Quorum

A majority of all the directors is usually the number that must be present in order for there to be a quorum and the meeting officially called to order. If less than a majority is there, no official business can be conducted (meaning that no binding decisions of the board can there be made). Unlike the quorum provision cited above for annual meetings, the departure of enough directors to diminish quorum DOES effectively adjourn the meeting, as no further business can then be conducted.

### Deciding Questions

All decisions of the board must be by majority vote, but the term “majority vote” is usually based upon the number of directors actually present so long as a quorum is present. Thus, if there are three directors on a five-person board present at the meeting, official decisions of the entire board of directors can be made by two of those directors present. As noted above, the proviso in Robert’s Rules of Order stating that the president or chairperson should only vote to break a tie is not applicable to community associations. Each director is elected to represent the owners and to vote on issues as he or she sees fit. This is part of every director’s fiduciary obligation to the owners and the association. If the president or chairperson is also a director, then he or she must vote—as a director—on every matter that comes before the board. His or her election by other directors to serve as president or chairperson does not supersede the obligation to the owners.

Similarly, if the president or chairperson wished to make a motion, he or she should do so as a director. To be procedurally correct under Robert’s, he or she should first step down as presiding officer long enough to make the motion, then resume the gavel and preside over discussion and vote.

### Proxies

Unless there is a VERY specific authorization in the documents or in applicable statutory law, board members may NOT vote by proxy. The reason for this is that each director is elected in his or her personal capacity to serve as director and vote on behalf of all other constituent owners. By accepting this obligation, the director is effectively already voting for that constituency as their proxy holder. That proxy could not be further assigned without the consent of every member of the constituency. Accordingly, directors who cannot attend a meeting suffer the same fate as our Senators and Representatives in Congress who cannot attend a session: their vote is not counted.

### Ballots

Few documents or statutes specifically provide for a written ballot of directors at a meeting of the board of directors. As a practical matter, it is much faster for a verbal vote to be taken and recorded in the minutes of the meeting, so most boards conduct business in that fashion. However, there are times and circumstances where a secret written ballot of directors might be appropriate. For example, the election or removal of officers might best be handled that way so that there is no acrimony among directors concerning those issues. A board wishing to take some votes by written ballot may wish to establish procedures and rules regarding the process and when it will be used.

### Agendas

Some rules of order state that the president or chairperson sets the agenda. Obviously, the person setting the agenda controls the meeting, although a preliminary motion at the meeting should be the approval of the agenda, in which case others may have input at that time. In many associations, it is the manager who sets the agenda, as he or she is the person most familiar with the business of the board which must be conducted at the meeting. Some boards allow any director to add items to the agenda at the beginning of the meeting.

Because many extraneous matters arise at association board meetings, it is important to have an agenda—and one that is as specific as possible—so that all necessary business is conducted without those other matters interfering. Some boards make very effective use of a timed agenda,



understanding that all necessary business should be fitted into a two-hour meeting time, as the attention of members is less focused after two hours.

### Owner Forum

Although the sunshine laws in effect in Maryland specifically require that all owners be notified of all board meetings, the presence of owners at a meeting can often be disruptive—even to the extent that necessary business is not conducted. Although the sunshine laws do not give the owners the right to be heard at the meeting, prudent boards find it politic to provide a time period during which owners can make comments. It is best if this “owner forum” occurs at the beginning of the meeting both so that owners can raise issues they would like the board to consider and because many owners will not be disruptive once they have been heard or their issue has been dealt with by the board.

The owner forum should have a finite time limit. If there are a great number of owners who wish to address the board, it is advisable to set speaking time limits, and not to allow anyone to speak twice until everyone has had an opportunity to speak once.

At the conclusion of the owner forum, the board should make it clear that the remainder of the meeting is the business meeting of the board and that owners will no longer be recognized or allowed to speak. It can sometimes have a great psychological impact on the owners if a couple of directors move around the board table so that their backs are to the audience. Doing so says that the board is meeting to discuss business, that the members are focused on each other (not the owners) and that the role of the audience has changed and is now merely one of observers, not participants.

### Executive Session

Both the Condominium Act (Section 11-109.1) and the HOA Act (Section 11B-111) set specific criteria under which a meeting of the board of directors may be held in closed or “executive” session. These criteria are:

1. Discussion of matters pertaining to employees and personnel.
2. Protection of the privacy or reputation of individuals in matters not related to the association’s business.
3. Consultation with legal counsel.
4. Consultation with staff personnel, consultants, attorneys, or other persons in connection with pending or potential litigation.
5. Investigative proceedings concerning possible or actual criminal misconduct.
6. Compliance with a specific constitutional, statutory or judicially imposed requirement protecting particular proceedings or matters from public disclosure.
7. By the individually recorded affirmative vote of two thirds of the board members present for some other exceptional reason overriding the general public policy in favor of open meetings.

The HOA Act adds one additional criterion: Consideration of the terms or conditions of a business transaction in the negotiation stage if the disclosure could adversely affect the economic interests of the association. These circumstances might exist if, say, the board was negotiating a contract and was willing to pay as much as \$5,000.00 for certain work, but was currently

negotiating to have the work done for \$4,000.00. Disclosure of the higher amount it might be willing to pay could cost the association \$1,000.00. However, under the normal contract bidding process, such circumstances would not exist, and closing a meeting to discuss competitive bids received would not be sanctioned under the Act.

Boards should also use caution in determining to invoke number 7, above, as it was specifically not intended as a “catch-all” provision allowing closed meetings for any purpose. The public policy of the Maryland legislature is that meetings should be open. This is especially true if the business to be discussed is of vital interest to the association—such as the delinquency list. Many boards mistakenly close the meeting to discuss delinquencies—whether the delinquents are in litigation or not—under the erroneous impression that they are violating a right of privacy. To the contrary, the collection of all assessments due from each owner is the business of both the board and every owner, and the discussion of delinquencies by the board should be open to the owners just as a discussion of any other financial business should be.

### The Chairperson

The key to a well-run meeting is a chairperson who acts with quiet authority and has good people skills. The chairperson must always be in charge of and in control of the meeting, but he or she should not be overbearing, confrontational, dictatorial, inflexible or always requiring center stage. Indeed, the chairperson must frequently walk a tightrope, intervening enough to keep the meeting on track but allowing others to participate as appropriate so that the business of the board gets done.

It is crucial to the conduct of any meeting that the chairperson remain above the fray and that he or she be composed, organized, soft-spoken, equitable, and obviously in charge without being overbearing. This is a tall order to fill, especially if the chairperson comes under personal attack. If the person who would normally chair the meeting is incapable of this demeanor, or if he or she feels some things might occur that will cause a loss of composure, that person should put aside custom or ego and allow someone else to chair the meeting. Once the chairperson becomes visibly angry, tearful, flustered, or frustrated, the meeting can degenerate. Similarly, a chairperson who is overbearing, confrontational, dictatorial, inflexible and egotistic will usually cause resentment such that all goodwill is lost.

Though the chairperson is in charge of the meeting, he or she should not ride roughshod over the members. The chair can diffuse anger and deflect personal attacks by the judicious use of advisors—such as management or legal counsel—or of experts—such as architects, engineers, and accountants. The success of the meeting may depend upon the presence of the right advisors or experts depending upon the issues that are likely to arise. The chairperson should also make good use of committee chairs, officers, and directors who can answer questions or explain issues or actions. The meeting need not and should not be a one-man or one-woman show.

At the same time, the chairperson cannot allow others to take over the meeting. He or she should see that specific assignments are carried out by those mentioned above, but that control of the meeting returns to the chairperson after each report or discussion. In fact, one sign of a good chairperson is that all heads automatically turn to him or her at the end of a report by another.

Note, too, that the chairperson should not allow discussion of an issue to continue interminably. When discussion becomes tentative, repetitive or meandering, the chairperson should ask “Are we ready for the question?” This language is better than “Is there any more discussion?” because that language can foster the continuation of what the chairperson has already perceived as fruitless dialog.

### Minutes of the Meeting

The minutes of the board meeting (and of the annual meeting) are the “official” record of what occurred at that meeting because they have been subsequently reviewed by the board (or the owners) and their content approved. This means that, prior to such approval, the minutes are not “official” and thus are not yet records of the association and should not be distributed. This can sometimes cause a delay in making the minutes available to the owners. Let’s say that the minutes from the January meeting are reviewed by the board at the February meeting, but extensive changes are required because the recording secretary neglected to include the discussions and decisions made during an entire section of the meeting. The minutes are sent back to be rewritten pursuant to the board’s direction at the February meeting, but are then not available for review and approval until the March meeting. This means that the “official” minutes of the January meeting are now available to the owners until March—which is problematical for a board that wishes to keep communication lines open with the owners.

One method of resolving the communication problem (an issue crucial in all associations) while still protecting the integrity of the association’s official records is for the board to agree upon a synopsis of the meeting at its conclusion. This synopsis might be nothing more than a short list of issues discussed and actions taken. Once approved, the synopsis can be published to the owners so that they are aware of how hard the board is working on their behalf. The synopsis can also be a vehicle for important announcements. For example, the synopsis might indicate that the board approved a contract to re-stripe the parking lots, and give the owners notice that all cars must be off the lots by 8:00 o’clock, a.m. on a certain day.

Once the minutes are made official, any notes of the meeting from which the minutes were derived as well as any tape recording of the meeting that may have been used to create notes or the minutes should be destroyed. This is so because notes and audiotapes may contain extraneous or even incorrect information that was later changed in the minute approval process. Also, an audiotape will not reflect gestures or facial expressions that might change the meaning of the words recorded and thus give a listener who was not at the meeting a false impression of the actual events at the meeting. For the same reason, boards may wish to adopt a policy preventing owners from taping meetings of the board or annual and special meetings of the owners.

### Content of Minutes

Minutes should contain all information necessary to make them an accurate record of the meeting, but should be as brief and to the point as possible. For example, it is sufficient to say that “The board discussed several bids for landscaping services and selected ABC Landscaping as the contractor for the coming year by unanimous vote.” There is no need to provide specific detail of the discussion, even if it took an hour of the board meeting to accomplish. There is also no need to recite the vote of each director if the vote was unanimous. However, when a decision is made with dissenting votes by some directors, it is important to record the fact of the

dissenting votes and, upon the request of those directors, the basis or reasons for their dissent. Similarly, management may wish the minutes to reflect a recommendation made by it that was not followed by the board.

#### Policies and Procedures Manual

Although the minutes of board meetings are the official record of those meetings, they are a cumbersome vehicle for locating the important policy resolutions of the board or specific procedural processes adopted by the board. This is so because the minutes contain a lot of other important, but routine, information. Any board member or manager who has tried to wade through years of board meeting minutes to find out if the board had a specific policy concerning, say, fining, knows what a difficult job it is.

The policies and procedures adopted a decade ago by the board at that time remain the policies and procedures of the association until modified or repealed by a future board. The “board” is a single, continuous legal entity just like the association. The directors who comprise the board change from time to time, but each set of directors has a legal responsibility either to follow the policies and procedures of the board or to change them. It is difficult to follow these policies and procedures unless you know what they are. It is for this reason that all associations should make it a practice to put all policies and procedures in writing and to keep them separate from the minutes.

## **[DRAFT] CODE OF CONDUCT**

### **FOR BOARD MEMBERS**

The \_\_\_\_\_ Board of Directors has approved the following code of conduct for its members in order to ensure that they maintain a high standard of ethical conduct in the performance of the \_\_\_\_\_ business, and to ensure that the residents maintain confidence in and respect for the entire Board.

The following principles and guidelines constitute the code of conduct:

No individual shall use his/her position as a Board member for private gain, for example:

No Board member shall solicit or accept, directly or indirectly, any gifts, gratuity, favor, entertainment, loan, or any other thing of monetary value from a person who is seeking to obtain contractual or other business or financial relations with [name of vendor, member, etc].

No Board member shall accept a gift or favor made with intent of influencing decision or action on any official matter.

No Board member shall receive any compensation from the Association or any third party for acting as such.

No Board member shall engage in any writing, publishing, or speech making that defames any other member of the \_\_\_\_\_ Board or resident of the \_\_\_\_\_ community.

No Board member will willingly misrepresent facts to the residents of the community for the sole purpose of advancing a personal cause or influencing the community to place pressure on the Board to advance a Board member's personal cause.

No Board member nor his/her agent or employee or family member shall enter into a personal service contract with the \_\_\_\_\_ without previous disclosure of such interest to the Board.

No Board member will seek to have a contract implemented that has not been duly approved by the Board.

No Board member will interfere with a contractor implementing a contract in progress. All communications with contractors will go through \_\_\_\_\_ site staff or management or be in accordance with policy.

No Board member will interfere with the system of management established by the Board and the management company.

No Board member will interfere with the duties of any staff member of the \_\_\_\_\_.

No Board member will harass, threaten, or attempt through any means to control or instill fear in a member of the staff.

No Board member will utilize homeowners' keys in any manner other than as outlined in the Key Policy passed by the Board of Directors on January \_\_, 20\_\_.

Any Board member who violates this code of conduct agrees that the Board of Directors may seek injunctive relief against him/her and agrees to pay the attorney fees incurred by the Board in that enforcement effort. The Board member also agrees that the Board shall be relieved of posting bond as a condition to its injunctive remedy.

No provision of this Agreement can be rescinded, altered, and/or amended without unanimous vote of the members of the Board of Directors.

_____ President	_____ Date
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_____ Vice President	_____ Date
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_____ Secretary	_____ Date
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_____ Treasurer	_____ Date
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_____ Board Member	_____ Date
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**[DRAFT] CODE OF ETHICS AND RULES OF CONDUCT FOR  
VOLUNTEER BOARD MEMBERS, OFFICERS, AND  
COMMITTEE MEMBERS**

WHEREAS, the Board of Directors of has the power and the responsibility to make decisions for the entire community, and

WHEREAS, the Board of Directors is responsible to appoint officers and committee members, and

WHEREAS, the volunteer leaders of the Association are responsible to set a standard and a tone for behavior that is conducive to the best interests of the entire community,

NOW, THEREFORE, BE IT RESOLVED THAT the Board of Directors of \_\_\_\_\_ hereby adopts the following rules of conduct, standards of behavior, ethical rules, and enforcement procedures that are applicable to all volunteers serving the community:

1. The Board of Directors will use its best efforts at all times to make decisions that are consistent with high principles, and to protect and enhance the safety and property value of the residents.
2. No gifts of any type worth \$5.00 or more will be accepted from any resident, contractor, or supplier.
3. No contributions will be made to any political parties or political candidates by the Association.
4. Confidentiality of other Board members' personal lives, all residents' personal lives as well as employees' personal lives, will be protected by the Board officers and committee members.
5. No interference between the Board of Directors or other volunteers and the employees will be undertaken, so long as a contract exists with a management company which prohibits such interference.
6. No promise of anything not approved by the Board as a whole can be made to any subcontractor, supplier, or contractor during negotiations.
7. No drugs, alcohol, or substance abuse will be tolerated.
8. Any Board member convicted of a felony will voluntarily resign from his/her position.
9. Board members will immediately remove any volunteer from such positions as officers or committee positions if said person has been convicted of a felony.
10. Any Board member under investigation for a felony will request a leave of absence from the Board of Directors during the investigation and trial period.
11. Language at Board meetings will be kept professional. Personal attacks against owners,

residents, officers, and directors are prohibited and are not consistent with the best interest of the community.

12. It is understood that differences of opinion will exist. They should be expressed in a clear and business-like fashion.
13. Proper parliamentary procedure should be followed to have such dissenting positions stated clearly within the official records of the Association.
14. A volunteer may not knowingly misrepresent any facts to anyone involved in anything with the community which would benefit himself/herself in any way.
15. No volunteer serving the community may use his/her position to enhance his/her financial status through the use of certain contractors or suppliers. Any potential conflict of interest must be exposed to the other volunteers, especially to the Board of Directors.
16. The Board of Directors will stand and face the community at their first Board meeting following their Annual Meeting and will raise their hands and agree to abide by this Code of Ethics and will sign the Code of Ethics.
17. This resolution of Rules of Conduct will be framed and kept posted in the Association's office. Each new volunteer will be given a certificate and will be asked to initial that they have received the certificate and have read it and agree to abide by it.
18. Violations of the Code of Ethics will be brought to the Hearing Board.
19. The attorney, management agent, and accountant, if any, for the association can serve as Advisory Hearing Board members if requested by the Hearing Board.

The resolution is adopted this \_\_\_\_ day of \_\_\_\_\_, 20\_\_ at an open Board meeting where a quorum of the Board was present and will become effective immediately.

\_\_\_\_\_  
President                      Date

\_\_\_\_\_  
Secretary                      Date



## **Ch. 4: Employee Hiring and Firing: Rules to Remember**

Condominiums, cooperatives and homeowners associations, particularly large ones, often hire employees or retain independent contractors to perform some of the association's responsibilities. Every such employer faces legal and practical risks whenever a new employee is hired and when an unsatisfactory employee is fired.

It is impossible to eliminate all risks, but a careful employer can reduce the likelihood of lawsuits and other problems arising from hiring and firing. The following rules should help:

### **I. Hiring**

1. Clearly define the job. Prepare a detailed job description, listing the responsibilities of the position and the tasks to be performed.

In preparing to review applicants, think about the knowledge, skills and other qualifications necessary to meet the requirements of the job description.

2. Carefully review resumes and applications, and think about the following:

- a. Is the applicant's experience relevant to the job?
- b. Are there unexplained gaps in employment history?
- c. Has the applicant changed jobs frequently?
- d. Does the resume reflect the applicant's attention to detail (or lack thereof)?
- e. If the job requires verbal, writing, typing or clerical skills, how are those reflected in the resume?
- f. When possible, have applicant's interviewed by more than one person.

3. Make the most of the interview, but Do NOT ask about the following, and be careful about discussions that raise related issues:

- a. race, sex, religion, national origin, or age, except that a person may be asked whether he or she is at least 18 years of age;
- b. marital status;
- c. number or ages of dependents;
- d. maiden name;
- e. pregnancy, childbearing or family responsibilities;
- f. type of discharge from the military service;

- g. general medical condition, state of health or prior illnesses;
- h. physical or mental handicaps, **except**, that, after explaining the essential functions of the job, the employer may ask generally whether the applicant has any restrictions that may interfere with his/her ability to perform the job;
- i. height or weight;
- j. whether an applicant ever has filed a claim for workers' compensation;
- k. assets, liabilities, or credit history, including bankruptcies or garnishments;
- l. whether an applicant ever has been arrested;
- m. union membership or preferences;
- n. whether the applicant would be willing to take a lie detector test;

## **II. Firing**

1. All rules and policies, including discipline and termination procedures, should be written down in a manual, and each employee should be required to sign an acknowledgment that he/she has received a copy. Make sure that the employee manual clearly explains the grounds on which an employee may be fired. Every employee should know what a "firing offense" is.
2. Except in extreme circumstances (e.g., an employee stealing, or committing some other serious misconduct), a graduated disciplinary process should be followed. When an employee breaks a rule or has unacceptable performance, the employee should be notified, in writing, immediately, and a copy of the memorandum should be kept in the personnel file. On these occasions, the employee should be counseled and not just reprimanded. The first objective should be to correct the unacceptable behavior.
3. Consistent with good judgment, personnel rules should apply consistently to every employee. Any perceived favoritism or differential treatment can lead to serious problems for the employer.
4. Document everything, in as much detail as possible. When an employee is fired, the employer should expect a legal challenge. Defending against such a challenge will be very difficult without a detailed file on the employee and the reasons for termination.
5. Before firing an employee, be sure to review everything with legal counsel.
6. When it comes time to fire an employee, the following process is recommended:
  - a. Schedule the termination for late afternoon. The end of the day on Friday is the best time to break the bad news. After being fired, the employee is not happy, but will have the weekend to recover. Also, the employee is spared the humiliation of clearing his/her work area of personal items in front of co-workers.

b. A meeting to fire an employee should not take more than 15 minutes. The employee probably already knows what's up. You can summarize the reasons for termination, but don't get drawn into an argument. If the employee threatens to sue, don't get defensive.

c. Always have a witness present during the meeting. The witness is there to listen and does not get involved in the discussion. Do not make a tape recording, and do not let the employee make one.

d. In appropriate cases, you may want to offer the employee the option of resigning. Resignation allows the employee a dignified departure. Also, employees who resign are less likely to file complaints.

e. You may want to offer the employee an incentive to resign, in the form of severance pay. However, severance pay is not required unless the employee's contract or established personnel policies require it. In exchange, you can ask for the employee to sign a waiver of all claims against the organization. Keep it simple. The more legalistic the waiver, the less likely the employee will be to sign it.

f. At the termination meeting you should be ready with a simple one line resignation letter (if resignation is to be an option) for the employee to sign. You also should have a simple termination letter (if you do not get a resignation), and any other documents that might be necessary, insurance forms, etc.

g. The employee should return keys, uniforms and equipment before leaving.

h. The employee should be assisted in collecting personal possessions and should be escorted out of the building, preferably by someone other than the person who did the firing. Employers always should be on guard to prevent possible disruption or damage that a disgruntled, terminated employee might cause if left alone.

i. After an employee is fired, he/she should not be allowed to come back to visit other employees.

No employer can avoid problems with employees from time to time, and there is no way to guarantee that every hiring and firing process will go perfectly. However, by following these guidelines, many problems may be avoided.

## **Ch. 5 - STORMWATER MANAGEMENT**

### **I. Introduction**

Nearly every community association in Montgomery County, Maryland has some type of stormwater management facility in its common areas - wet ponds, dry ponds, sand filters, infiltration trenches, oil/grit separators, underground storage structures, etc. The cost to maintain those facilities is one of the highest expenses a community association faces, along with general landscaping, maintenance of recreational facilities such as pools and pool houses and insurance.

### **II. The Turnover Process**

County, State and Federal laws require the construction and maintenance of stormwater management facilities to deal with erosion, sediment control, and stormwater runoff. Until 2002, the cost in Montgomery County was born by the individual unit owners in the community association. In 2002, Montgomery County adopted amendments to Chapter 19 of the Montgomery County Code which created a procedure for the County to undertake the responsibility for structural maintenance of stormwater management facilities. By completing this procedure, community associations can become responsible only for nonstructural maintenance, which includes such issues as preventing the accumulation of solid waste, and controlling growth of weeds, trees or brush which might adversely affect the functioning of the stormwater management facility. Turnover to the County of the responsibility for structural maintenance relieves the community association of the expensive burden of accumulating and maintaining a reserve for major capital maintenance, repair and replacement of its stormwater management facilities. The community association does not, however, relinquish ownership of the facilities.

The turnover process will require the assistance of professionals, including attorneys, title examiners, engineers, and environmental specialists, depending upon the nature and condition of the stormwater management facility.

The first step is to identify the facilities which the community association has the responsibility to maintain.

This includes determining whether the community association owns the facility or has other contractual obligations to maintain the facility. Such information is normally in documents recorded in the Land Records for Montgomery County, Maryland in the form of declarations of covenants for maintenance and grants of stormwater easements.

### III. Community Responsibilities for Stormwater

Next, the community association must identify what its responsibilities are. The obligation to maintain a stormwater management facility usually arises from the ownership of the facility located in the common areas of the association. However, it can also arise from covenants or easements which place responsibility for maintenance upon an association even though it does not actually own the facility.

The legal documents recorded when the stormwater management facility was created will identify not only the responsibilities associated with it, but will also determine the procedure for having the County assume structural maintenance. As indicated, those documents usually include a maintenance covenant, and a grant of stormwater management easement. Other documents to review are the governing documents of the association - in particular the declaration of covenants and any related easements or recorded documents - as well as the record plats recorded in the Land Records which identify the parcels owned by the association and/or the parcels on which the stormwater management facility is located. More recent facilities, built within approximately the last ten years, usually have the most complete set of documents. Often surveyor drawings

accompany grants of easements and the facility is identified in record plats as well. To the extent that the records identifying the facility, the ownership of the facility and the responsibility associated with the facility are complete, there is less need for professionals to accomplish the transfer.

The greatest practical difficulty in the process of turning over a facility is obtaining a sufficient legal description of the stormwater management facility to prepare the necessary legal documents.

The County has provided form documents on its website, but every facility naturally has its own description. If the maintenance, covenants and stormwater easements contain plats or legal descriptions, or the record plats contain legal descriptions or boundaries, then the task is easier. There may be cases however where a community association actually has to retain the services of an engineer and/or a surveyor to plat the facility. Recent experience has shown that those cases are rare but they do exist.

Some of the thornier legal issues which have surfaced include the following:

Some community associations find when they are preparing to turn over structural maintenance of a stormwater management facility that the facility has never been deeded to the association, even though it may have been maintaining for some time and at some expense. Then the community association must find the record owner of the facility and obtain a deed transferring ownership to the community association. Usually the intention at the outset was that the community association would own the facility but sometimes this step is inadvertently dropped.

Sometimes the community association is responsible for maintaining a facility, pursuant to recorded documents, which it does not own. This can occur for example where a homeowners association in a planned development which includes both homeowners associations and

condominiums, is responsible for maintaining the stormwater management facility, but the facility is located within the common elements of a condominium. Normally the operative legal documents sufficiently describe the legal relationships to enable the turnover.

Sometimes stormwater management facilities serve more than one development.

If the legal documents have provided for one entity to maintain the facility, then that entity may take the lead in the turnover. Otherwise, all owners of the land on which the facility is located will have to be involved. They might not all be community associations.

The stormwater management facility could for example serve a condominium and a rental apartment complex both of which might be involved in the transfer, depending upon what the recorded documents say.

A condominium with a stormwater management facility has a unique problem. While the facility may be located on the general common elements, because of the nature of the ownership in a condominium, there will be no specific deed from a developer to the condominium for the facility. Rather, all unit owners own the facility as tenants in common. What this means is that a title examiner will have to locate the original documents which the developer recorded for the facility, which should have been recorded prior to the creation of the condominium. The condominium is still responsible for the facility, but the transfer of ownership of the facility occurs through the transfer of individual units to the unit owners who own the entire condominium project in common with each other. A homeowners association, on the other hand will normally have a separate deed establishing its own separate ownership of the facility.

The community association will prepare an original easement and an original declaration of covenants for maintenance, or it will prepare an amendment to an already recorded declaration of covenants for maintenance if an original easement and an original declaration have been recorded. These documents are executed in the same way as any other documents, signed by the

president or vice president, attested by the secretary and notarized. A condominium has an additional procedure that there must be notice to the unit owners and a meeting of the Board of Directors at which the decision to grant the easement is passed by a majority of a quorum of the Board.

The community association then submits the documents to the Department of Environmental Protection. They are forwarded to the County Attorney, reviewed for legal sufficiency and if they are in order then the County Executive signs them. While this process is going on, the County will inspect the facility and the community association must make any structural repairs needed to place the facility in proper working order as determined by the County before the County will enter into an agreement that obligates the County to assume responsibility for structural maintenance of the facility in the future.

If the facility has passed inspections and the County has executed the documents, the documents returned to the community association for recording in the Land Records. Once the documents are recorded, they are resubmitted to the County together with a completed application for turning over structural maintenance of the stormwater management facility. The community association will receive a letter from the County advising that the County has accepted responsibility for structural maintenance of the facility. The community association has continued responsibility only for nonstructural maintenance thereafter.

The County's cost for performing structural maintenance of stormwater management facilities is raised by a Water Quality Protection Charge which appears on the tax bill of all residential and certain nonresidential properties in the County. Authority for the tax is established in the County Code and the procedures for fixing the amount of the tax are established by County Executive regulation. The charge appears on annual tax bills and is collected in the same manner as property taxes.



This brings up another issue. Community associations are not accustomed to paying real estate taxes. Common areas are assessed at nominal or no value and therefore no taxes are due. However, the Water Quality Protection Charge changes this. Condominiums do not face this issue but homeowners associations do.

Homeowners associations which own stormwater management facilities will receive tax bills which have a Water Quality Protection Charge for the property they own. If they do not pay the Water Quality Protection Charge, the property will go to tax sale and could be lost or, more likely, great difficulty and expense will result in trying to redeem the property after it is sold.

Homeowners associations have not had to pay careful attention to their tax bills, and therefore several problems may have arisen which will now have to be addressed. There are numerous instances where developers have failed to provide the taxing authorities with the new address of the homeowners association, as a result of which the homeowners association has never gotten any tax bills. When a homeowners association changes management companies, at times a change in address is not filed with the County Department of Finance and therefore the tax bills will go to the former management company. As said above, this has not mattered a great deal until now, but with the Water Quality Protection Charge it does matter whether or not the tax bill is paid.

By the use of the website for the Maryland Department of Assessments and Taxation, and /or the services of a title examiner, a community association can determine what properties it owns, and can correct records so that it is receiving necessary tax bills. It is important to know that the Water Quality Protection Charge will appear on tax bills for most common areas, whether or not a common area has a stormwater management facility located on it.

Questions about the process for locating stormwater management facilities, and accomplishing their turnover can be answered by accessing the Montgomery County, Maryland

website, Department of Environmental Protection, Stormwater Maintenance Program, or by calling the Montgomery County Department of Environmental Protection directly.

## Ch. 6 – REPLACEMENT RESERVES

### I. Definition of Replacement Reserves

Maryland law requires that community associations accumulate funds towards future replacements. The idea behind this is for owners in a community to contribute their fair share of the cost to maintain the community infrastructure. Since most residents remain in communities for relatively short periods of time, this system, when fairly implemented, prevents any one group of residents at a specific time from bearing a disproportionate share of the cost of large replacements.

### II. Deciding Replacement Reserves

A reserve study is a budget planning tool that identifies items to be included in the reserves, estimates their replacement cost and remaining service life, and calculates the annual assessments needed to fund the projected expenditures. The reserve study consists of two parts: the physical analysis and the financial analysis.

Most communities engage a professional property manager, engineer, or reserve analyst to perform a reserve study to calculate the appropriate level of reserve contributions. For many communities, a single knowledgeable individual can adequately assess the property and calculate the needed reserves. A large and complex properties, a team of professionals with specialized knowledge of building systems may be more appropriate.

Parties with a role in deciding reserves include the following.

- Community representatives. This includes the Board and possibly a committee of interested community members.
- Management staff (for properties with professional management).
- Engineers, architects, reserve specialists, or other qualified individuals.
- Community accountant/auditor.
- Financial consultants.

### III. When To Do A Reserve Study

Because calculating reserves involves future projections and estimates that cannot be perfect, a reserve study is a dynamic document that requires periodic reviews and updates. The consensus of the community management industry is that management and the Board should review and adjust the reserves annually, and that a detailed review by a qualified independent third party should be done at least every five years. Each reserve study is based on an assessment of the property's condition at a particular time. The assessment and expenditure projections change with changing conditions.

### IV. The Role of Community Goals in Deciding Reserves

The community's objectives largely determine the reserves. Some communities wish to minimize current expenses and are tolerant of less-than-perfect appearances. Some communities wish to keep the community in first-class condition at all times. Most communities fall somewhere in between these two extremes. However, the ongoing cost of maintaining a first class property is substantially more than the cost to fix or replace components as they break. A community needs a clear definition of their objectives to decide the appropriate levels of assessments for reserves.

### V. Basic Components of a Reserve Study

A full reserve study includes a *physical assessment* of the property and a *financial analysis* of the reserve funding.

The physical analysis includes an inventory of property components, an assessment of their current condition, an estimate of their service lives, and an estimate of their value.

The financial analysis includes calculations of future expenditures and the method of funding the expenditures.

## VI. Types of Reserve Studies

Reserve studies and their constituent parts can be classified as follows.

	Full reserve study	Update study with site visit	Review study with no site visit
Component inventory	X		
Component verification		X	
Life & valuation estimate	X	X	X
Financial analysis	X	X	X

## VII. Information to Include in a Reserve Study

The following basic information should be included in a reserve study.

- Number of units
- Type of community
- Number of buildings
- Description of the physical assets
- Year built
- Level of investigation
- Sources of information

A list of components is needed for calculating the future expenditures. The following list is not exhaustive and many items may not apply to a given property. This list is intended to illustrate the types of items normally found in reserve studies.

- Replacement of mechanical, electrical, and plumbing equipment.
- Major overhauls or rebuilding of large equipment.
- Replacement of water distribution piping and drain pipes. The service life of piping is long but finite. When it needs replacement, the costs can be substantial because of the difficulty of access and working in an occupied building.
- Elevator modernization or replacement. Many communities have “full service” elevator maintenance contracts that appear to cover all replacements. However, they normally only cover replacement in kind. When controls and hoisting equipment needs modernization, these service contracts normally will not cover modernization costs.
- Replacement of major components of fire protection and fire alarm systems. Building codes require annual testing of terminal devices in fire alarm systems and replacement of these devices is usually included in the annual operating budget rather than reserves.
- Replacement or overlays of pavement and walkways.
- Replacement of retaining walls, fences, and other site improvements.
- Cleaning or dredging storm water ponds.
- Major drainage improvements. As settlement and erosion change ground profiles, costly drainage improvement projects are often needed.
- Swimming pool equipment and piping.
- Swimming pool decks, fences, tile, coping, white coating, and fixtures.
- Recreation courts and equipment.
- Vehicles owned by the community.
- Large repairs and refurbishing of building exteriors and facades. For high rise buildings, this can be one of the most costly items.
- Balcony and deck repairs and replacements.

- Replacement of railings and hand rails.
- Roof replacements.
- Parking garage repairs.
- Waterproofing and toppings on plazas over underground structures.
- Common area interior redecoration and replacement of furnishings.
- Office equipment owned by the Association.
- Replacement of common element doors and windows.
- Large repair or maintenance projects that occur every few years. For example, if painting, caulking, and replacing rotted wood trim on a large building costs tens of thousands of dollars and is done every five to ten years, this cost is usually included in reserves.

## **VIII. Other Criteria for Inclusion in a Reserve Study**

Other considerations for inclusion of items in reserves may include the following.

- A threshold amount may be applied. For example, many communities do not include items with a cost of less than \$5,000.
- A time frame for the analysis is either explicitly or implicitly used. For example, many studies explicitly show a study period of 20, 30, or 40 years. The minimum recommended time frame is 20 years. However, all components have a finite life, even the building structure. Consequently, a time frame is implied even if not explicitly stated. Ultimate service lives of basic components like the building structure and utility lines can be a significant factor in older properties.
- Some items are never replaced in their entirety. Concrete sidewalks are a common example. Accepted management practice is to replace damaged sections every few years. There are several different ways that this can be handled in making reserve assessment calculations.
- The effect of service contracts on equipment replacement needs to be considered. The example of elevators was discussed above.

## **IX. Determining the Value of Components**

The following information is used to determine values of reserve items.

- Remaining useful life and normal useful life. There are published useful service lives for most property components, but the actual performance of a component in a given property depends on many factors that cannot be anticipated by the published information. This is why the physical assessment is important.
- Current replacement cost. Original construction costs are normally inadequate because working in an occupied property is entirely different than new construction. Costs are usually estimated based on the quantity and unit cost for a component.

There is no fixed or correct value for a given item. As anyone who solicits proposals for repairs or maintenance knows, the value of an item is influenced by many factors, including the following.

- Anticipated seasonal weather changes. The time of year for the often influences cost, especially if outdoor work is involved.
- The contractor's current work load. The markup will usually be higher if the contractor is busy.
- Labor costs. Labor costs typically account for a higher percentage of the project cost on repair work than on new construction. Labor is considered by the contractors to be the highest risk and therefore it can be highly variable. Labor rates and productivity vary between contractors, therefore, different contractors may submit different bids for the same well-defined tasks.
- Project conditions. New construction occurs on a job site controlled by the contractor. Repairing an occupied building is influenced by many factors beyond the contractor's control. Therefore, the contractor's perception of the job conditions has a large effect on

cost.

A reserve analyst's cost estimates for repairs and replacements will differ from the actual costs. One reason is the complete details of the proposed work are not known when budget estimates are made. Also, industry experience is that bid prices for repair and restoration work vary widely for the reasons noted above, even when contractors are basing their pricing on detailed plans and specifications. It is not unusual for bids to vary by 100% from the low to high firm even with extensive information for bidding.

## **X. Limitations of Reserve Studies**

A reserve study is *not*:

- A warranty.
- A verification of code compliance.
- A detailed engineering analysis or evaluation of past or future design modifications.
- A specification for replacement or repair.
- A prescription for how the Association must provide funding.
- A statement about the tax status of individual expenditures.

## **XI. Special Considerations for New Communities**

In new communities, the developer usually collects data for computing the reserve assessments before construction begins. This is because information must be provided before construction for participating builders and public offering statements. Changing the reserve information as communities are developed may jeopardize contracts. Consequently, the basis for computing the reserves often changes between the time the developer publishes community budgets and the time the community is fully built out and sold. It is advisable for communities to perform a full reserve study as a part of the transition from developer control.

## **XII. Special Considerations for Large Communities**

Many large communities are delivered in phases. It may be important for reserve studies to take into account the timing of components as they are delivered. Often the community design evolves and adjustments in the reserve calculations are needed. Many large communities have multiple associations with complex boundaries and divisions of responsibility. These distinctions need to be accounted for in reserve calculations.

## **XIII. Special Considerations for Mature Communities**

Mature communities often have well defined objectives and long term plans that have resulted from years of planning effort by community members, professional managers, and other parties. For these properties, reserve studies should be a collaborative effort involving the Board, professional manager, reserve analyst, and auditor or accountant.

## **XIV. Special Considerations for High Rise Buildings**

- Often these buildings have complex systems that require more expertise to assess.
- Treatment of assessments may need adjustment when all units do not have the same components. For example, all units may not have balconies and the community policy may be to apply assessments for balconies only to those units that contain balconies.
- The largest costs are usually associated with the exterior envelopes, garage structures, and plazas, not the mechanical components

## **XV. Special Considerations for Mixed Use Communities**

- It is essential to understand the boundaries and division of responsibilities.
- Some items may be shared and funding responsibility shared.

- Different parts of the community may have different standards and expectations that will affect the reserve amounts.

#### **XVI. Special Considerations for Older or Historic Properties**

- Effects of architectural district restrictions must be considered.
- Older properties usually have higher levels of funding requirements than newer properties.
- Funding requirements for rehabilitation of electrical power distribution, and plumbing systems may be difficult to estimate.
- Structural rehabilitation may be needed.

#### **XVII. Methods of Calculating Reserve Assessments and Funding**

Prior to the availability of computerized spreadsheets, the calculation of reserves was very tedious and many simplifying assumptions were used to make the process practical. As the use of computer spreadsheets became common, the ideas of the simplifying assumptions became confused and many erroneous ideas about different answers produced by different calculation methods have become widespread. Mathematically, the fact is that *all calculation methods will yield exactly the same answer if the assumptions are the same*. The perceived differences lie solely in hidden differences in the assumptions made by the reserve analyst.

Reserve calculation methods can be classified as follows.

- Traditional component method. This was the method used before computer spreadsheets. The assessment is determined by dividing the replacement cost by the number of years of service life. Inflation was not included in the analysis. Different managers had different methods of adjusting for inflation.
- Component method with inflation. This is the same as the traditional component method except that an inflation rate is assumed and incorporated into the calculation.
- Cash flow method. The projected expenditures are arranged in chronological order and the assessments needed to fund the cash flow is determined.

Most reserve analysts use one of the two latter methods of calculation because the traditional component method underestimates reserve funding requirements since inflation is not considered. The cash flow method is most often used because it shows a clear picture of the anticipated costs and timing in a way that is useful for property managers. Another reason cash flow methods are popular is that component method calculations provide less flexibility in modeling project phasing, variable contributions, and funding alternatives than cash flow methods. However, as noted above, all calculation methods yield the same answer if the underlying assumptions are the same.

#### **XIX. Other Considerations in Making Reserve Calculations**

The following issues often arise in considering reserve calculations.

- Increasing the annual assessment at the same rate as inflation makes the analysis insensitive to varying inflation rates.
- Putting interest on invested funds back into reserves substantially decreases the amount of assessments needed over time.
- Phasing projects usually does not decrease funding requirements. It usually increases the overall funding needed, especially when inflation rates are high.

## **Ch. 9 – FINANCIAL PROCEDURES FOR RESIDENTIAL ASSOCIATIONS**

### **I. ACCOUNTING SYSTEMS**

There are two common types of accounting systems, the cash system and the accrual system. The cash system records income and expense transactions as the cash is received or paid out. This is the most common system of accounting for small associations with few transactions. The accrual system records transactions in the period when they occur or are due, not necessarily when the cash is received or expended. Examples of major accounts that are included in the accrual system, but not in the cash system, are accounts receivable, prepaid expenses, accounts payable, accrued expenses and prepaid assessments. The accrual system is more complex to prepare than the cash system but it gives the association a more complete picture of its financial situation.

Accounting systems utilize several records for recording financial transactions. Cash receipts and cash disbursement journals are used as chronological records of detailed transactions. Data from these journals are then entered into a general ledger, which is organized by accounts classified into assets, liabilities, equity, income and expense. The financial statements are prepared from the general ledger balances. Therefore the accounts in the general ledger should correspond to the accounts outlined in the association's budget so that comparison between periodic financial statements and the budget can be made.

### **II. FINANCIAL STATEMENTS**

The association's Board of Directors needs timely, comprehensive financial information to make financial decisions. An understanding of the association's financial condition is also helpful to potential buyers in assessing their possible investments. The basic components of the financial statements are: balance sheet, income statement, statement of changes in members' equity or fund balances and statement of cash flows.

#### **a. The Balance Sheet**

The balance sheet reflects the association's financial position at a point in time. It is comprised of three major categories: assets, liabilities and members equity or fund balances. The term balance sheet applies to the accounting equation that assets equal liabilities plus member's equity or fund balances.

##### **Assets:**

Assets represent what the association owns and will generally include cash, investments, accounts receivable, prepaid expenses and fixed assets (property and equipment less accumulated depreciation).

##### **Liabilities:**

Liabilities represent what the association owes to others and includes accounts payable, prepaid assessments and accrued expenses. Less common liabilities include notes payable (if the association has borrowed funds) and mortgage payable (for an association owned unit).

##### **Members' Equity:**

Members' equity represents the association's net worth at a point in time: what it owns (assets) minus what it owes to others (liabilities). The members' equity is generally divided into two categories: replacement reserves which represents the amounts designated for future major repair and replacement of the common property components and unappropriated members' equity which represents the



accumulated excess operating funds that the association has accumulated since its inception. An initial working capital fund or special project fund may also be included within the unappropriated members' equity section. Initial working capital represents a contribution of initial homeowners to fund start up expenditures of the association. The special project fund is established to temporarily fund a project designated by the association.

If the association uses fund reporting (see below) the titles of the equity section would become Fund Balances and the categories would become replacement reserve fund and operating fund.

#### **b. Income Statement**

The income statement reflects the financial activity of the association for the period. Assessments, other revenues and expenses are summarized by category and show the net profit for the period. To be most informative income statements should include the current period activity, year-to-date activity and budget comparisons.

#### **c. Statement of Members' Equity**

The statement of members' equity reflects the transactions in each account in the equity section of the balance sheet. It reconciles the beginning and ending fund balances with the results of operations for the period. Inter-equity transfers are also reflected on this statement. This financial statement is often not included as part of the monthly financial reports. At the year-end it may be included as part of the income statement instead of as a separate statement.

#### **d. Statement of Cash Flows**

The statement of cash flows shows the sources and expenditures of cash for the period. It is broken down into operating, investment and financing categories. Operating cash is generated by member assessments for the most part and expended for operating expenses. Investing cash may reflect the change in investments from the prior period and payments for fixed assets, for example. Financing cash represents cash received or expended for loans, initial working capital contributions and inter fund equity transfers and borrowings. The statement of cash flows also reconciles the net income from the income statement to the cash balance on the balance sheet.

The statement of cash flows is obviously not necessary for a cash accounting system and may or may not be included in a monthly financial report for an accrual system.

### **III. AUDITS**

An annual audit by a Certified Public Accountant provides reasonable assurance that the association's financial statements are free of material misstatement and present fairly the financial condition of the association in accordance with generally accepted accounting principles. The audit includes examining, on a test basis, invoices and other original source documentation, evaluating the accounting principles used and the financial statement presentation. The audit does not include examination of every transaction nor can it verify the accuracy of the financial statements beyond a reasonable assurance. The audit is also not designed to detect error or fraud that is not material to the financial statements.

#### **a. Compilation**

A compilation is limited to presenting financial statements from information prepared by the association. It does not include audit or review procedures and will not provide any more assurance than the statements produced by the association itself.

#### **b. Review**

A review consists primarily of inquiries and analytical procedures and provides very limited assurance that the financial statements are presented in accordance with generally accepted accounting principles.

The association's legal documents or state statutes may require an annual audit. Even without this requirement, it is prudent for the association to elect to have an audit performed rather than a compilation or review. The audit provides an added assurance for the association that the financial statements reasonably present the financial condition of the association. Since the audit is prepared by an accounting firm familiar with the unique issues of community associations, the association has further assurance that tax issues, replacement reserves and funding are handled correctly.

#### **c. AICPA Audit Guide**

Originally issued in 1991, the AICPA Audit and Accounting Guide: Common Interest Realty Associations describes conditions and procedures unique to the industry and provides uniform accounting treatment for a. The guide is updated periodically to reflect recent pronouncements.

#### **d. Fund Accounting**

Associations conduct and report on two primary kinds of activities: a) normal maintenance and service operations and b) long-term major repair and replacement requirements. Associations usually assess their members for both purposes and generally should report such assessments separately. The AICPA Audit Guide above recommends, but does not require, fund reporting for associations because it is the most informative method of presenting these separate activities. Under fund reporting, the financial presentation for the operating fund and the replacement fund should each include information about assets, liabilities, income and expense activities and fund balances. Assets included in the replacement fund usually consist of cash and investments. Liabilities in this fund are generally for work done on contracts for major repairs and replacements.

As a result of fund accounting, an association may have interfund receivables or payables from either of the following:

- Obligations of one fund are paid for with the assets of the other fund
- Amounts assessed for the activities of one fund are collected, but not transferred, by the other fund.

Corresponding interfund receivables and payables should be presented to highlight the transactions resulting in these balances and to provide information about amounts assessed and collected that were not used in accordance with the budget.

#### **e. Contents of a Standard Audit Report**

The standard audit report includes the following items:

- Opinion
- Balance sheet
- Statement of revenues, and expenses
- Statement of changes in fund balances or statement of members' equity
- Statement of cash flows
- Footnotes
- Supplementary information on Future Major Repairs and Replacements

The opinion page is self-explanatory, it emphasizes that the financial statements are the responsibility of the association's management and the audit expresses an opinion that, in all material respects, the financial statements present fairly the financial condition of the association in conformity with generally accepted accounting principle.

If, for any reason, the audit does not express a clean opinion, the explanation will be described on the opinion page.

The basic financial statements (balance sheet, statement of revenues and expenses, statement of changes in fund balances and statement of cash flows) have been described previously. Under fund reporting, however, the financial statements will consist of a column for the operating fund, a column for the replacement fund and a total column. Comparative financial statements are not required but they enhance the usefulness of the reports and illustrate more clearly the nature and trends of current changes affecting the association.

Footnotes disclose certain information about the nature of the association including: its legal form, services, tax status and filing, common property, special assessments, number of units owned by the developer, funding for future major repairs and replacements, assessments that were used for purposes other than those for which they were designated, related parties, significant sources of revenue and other disclosures as deemed necessary under the circumstances and as required under generally accepted accounting principles.

The AICPA Guide requires associations to disclose additional information about future major repairs and replacements of its common property. This supplementary information is outside of the basic financial statements and is not audited by the auditors. Included in the presentation of components to be repaired and replaced are estimates of the remaining useful lives of the components, estimates of current or future replacement costs and amount of funds accumulated for each component to the extent designated by the association's board or directors.

#### **f. Management Letter**

During the audit, the auditors may note matters that should be brought to the attention of the board of directors. Though not required, the auditor may prepare a management letter which addresses any financial or operational aspect of the association as a method of providing opportunities for improvement or relaying pertinent information. Comments frequently included in management letters generally fall into the following broad categories: legal documents, accounting procedures, replacement reserve fund, insurance, taxes and other issues.

#### **g. Representation Letter**

The representation letter is addressed to the auditor and is signed by the association's officer(s) and, if applicable, the management agent. The letter is important to remind the officers and management agent of their responsibility for the financial statements as well as their responsibility to provide the auditors with complete and accurate information. The auditor is required by auditing standard to obtain a signed representation letter as part of the audit of the association's financial statements.

## **CH. 10 - ASSESSMENTS AND THEIR COLLECTION**

All community associations - condominiums, homeowners associations, and cooperatives  
- sustain themselves by collecting assessments from their members.

### **I. Authority to Assess Financial Obligations on Owners**

The authority to collect those assessments is recognized in Maryland law and is created by documents recorded in the land records. In the case of homeowners associations, the document is usually a declaration of covenants; in the case of a condominium, the document is usually a declaration with accompanying by-laws; in the case of a cooperative, the document is usually articles of incorporation and a lease.

#### **A. The types of charges which a community association may collect include:**

1. Annual assessments;
2. Special assessments;
3. Collection costs in connection with collecting delinquent assessments;
4. Administrative costs in connection with collecting assessments;
5. Late fees;
6. Interest on delinquent assessments;
7. Legal fees.

A community association can only collect those charges which its documents specifically allow. If the documents do not allow late fees, then it cannot collect late fees unless it amends its documents. The same is true with interest, legal fees, collection costs and administrative costs.

**B. Annual or Special Assessments:** Assessments are usually either annual assessments or special assessments. The annual assessment is the most typical charge which a community association collects. Normally the operative documents provide that the members of the

association are responsible for an annual assessment to fund an annual budget adopted either by the Board of Directors, or in some cases by the members themselves.

The annual assessment must be sufficient to cover the costs identified in the budget, which include both operating costs and contributions to reserves for replacements.

Most community association documents also allow for collection of what is called special assessments. These are usually assessments imposed only after the vote of the members, on a one time basis to meet special needs for emergencies. There may be limitations in the documents on whether a special assessment can be collected over more than one fiscal year.

C. Fixing Amount of Assessments: Normally, fixing assessments is a two-tiered process. The board of directors adopts an annual budget and fixes an assessment which will pay for that budget. The board can raise the annual assessment, but only by a limited amount. To raise the assessment above that limit requires a vote of the members. The limits are identified in the governing documents.

D. Statutory Limits: There are also statutory limits on some of the charges which may be collected. In particular, the limit on interest is 18% for condominiums, and, if not otherwise specified, 6% for homeowners associations. Late fees may be collected only once on each late payment, and the amount of the late fees is also limited by statute.

As said above, the most commonly seen assessment is the annual assessment. The annual assessment is usually collected in monthly or quarterly installments. The community association also usually has the right to accelerate the annual assessment, for one year at a time, if the member is delinquent. The amount of acceleration can only be the balance of what will be due in the current fiscal year, which is normally a calendar year. Thus, for example a member may have the right to pay a monthly assessment by the 10<sup>th</sup> of each month, but if the assessment is not paid in any given month, then the right to pay monthly is lost and the entire balance for the rest of the

fiscal year is due and payable immediately. Interest will usually run on the full amount from the due date.

Normally, community associations adopt by rule collection policies which address due dates for assessments, interest, collect costs, administrative costs, late fees and legal fees, all as permitted by their documents and by applicable statutes. Collection policies can also address the allocation of assessment payments. For example, a collection policy may state that any payment will be applied to the oldest balance due first, or apply to outstanding costs and legal fees first and then to assessments or any other combination of formulas.

## II. Collection Options

No community association has a zero delinquency rate. Consequently the community association, its managers, accounts and attorneys must all become familiar with collection options. In Maryland there are two options. The first is to file a lien against the unit under the Maryland Contract Lien Act. This statute has procedures for notice to property owners, opportunities to challenge or question the amounts due, legal relief, and ultimately legal action in the Circuit Court for Montgomery County, Maryland. If a lien is filed, then the association may collect that lien by a foreclosure action much the same as a foreclosure on a mortgage or deed of trust by a lending bank.

The second option is an action in the District Courts of Maryland, which have jurisdiction up to \$25, 000. Most of the claims in the District Courts for assessments will be what are called small claims, that is \$5,000 or under. (The \$5,000 limit becomes effective on October 1, 2003). A small claim is heard before a judge, but on an informal basis. Usually, but not always, a trial is involved in which the plaintiff is the community association and the defendant is the member who owes the assessment.

The advantage of the statutory lien under the Maryland Contract Lien Act is that it is a fast procedure for placing an obstacle on the transfer of ownership to property without first paying the overdue assessment. The disadvantage is that payment can only be from a sale of the property if the member does not pay voluntarily.

There is no access to other assets of the debtor to pay the lien. Additionally, the process for foreclosing on a statutory lien is expensive.

The advantage of a judgment in District Court is that it can reach any asset of the debtor - real property or personal property, including bank accounts, automobiles, wage garnishments, etc. A judgment is less expensive to enforce after it is obtained, in addition to the advantage that it reaches more assets.

There are Federal laws which govern the collection of assessments, in particular the Fair Debt Collection Practices Act. This law requires certain specific notices to a debtor regarding the nature of the debt, the identity of the creditor, the opportunity to receive verification of the debt and the filing of legal actions. This law also limits the kind of contacts which a creditor or a creditor=s agents may make with a debtor. The act also limits such practices as publishing the names of debtors, calling debtors at work or at home and contacting debtors through the mail.

The Fair Debt Collection Practices Act defines the term “debt collector” and then proscribes collection tactics of debt collectors. A debt collector is, broadly, anyone who regularly collects debts owed to another. When a debt collector contacts persons to locate a debtor, for example, the debt collector is not permitted to state that the debtor owes any debt, is limited to the number of times it can communicate with persons, may not communicate by postcard, and,

after the debt collector knows that the debtor is represented by an attorney, must communicate through the debtor's attorney.

A debt collector may not communicate at unusual times or places with a debtor.

There are limits on communicating with third parties about the debt and on communicating with the debtor after the debtor has asked that communication cease. The statute addresses harassing or abusive conduct such as the use or threat of violence, the use of obscene or profane language, the publication of a list of debtors and engaging in annoying telephone calls.

The statute also prohibits misleading representations, such as the threat to take any action that cannot be legally taken or that is not intended to be taken.

The foregoing is a broad statement of the types of activities controlled/prohibited by the Fair Debt Collection Practices Act, but is not a substitute for reviewing the Act itself. These examples should be sufficient to alert community associations to the issues. The penalties for violating the Fair Debt Collection Practices Act can be severe and expensive .

### III. Bankruptcy Considerations

Any discussion of assessment collection must include the issue of bankruptcy.

Community associations typically see two types of bankruptcy, Chapter 7 and Chapter 13. On rare occasions they may see a Chapter 11, which is similar to but not identical to a Chapter 13.

A Chapter 7 bankruptcy involves a sale or liquidation of all assets not protected by law to pay eligible debts; thereafter the debtor is discharged from those debts.

A Chapter 13 bankruptcy is a proceeding which involves a plan for repayment of debts over three to five years. In the course of a Chapter 13, debts may be paid and/or discharged just as in a Chapter 7.



The community association may no longer pursue any debt which arose prior to the filing of the bankruptcy. The date of filing of a bankruptcy is therefore an important date. For condominiums, a debtor remains responsible for condominium assessments so long as the debtor resides in the condominium.

For homeowners associations, a debtor remains responsible for assessments so long as the debtor owns the property.

Where there are assets in a Chapter 7, and in virtually every Chapter 13, the community association should file a proof of claim. A proof of claim sets forth the amount owed by the debtor to the association at the time of the filing of the bankruptcy. Debts are paid in order of priority established by bankruptcy law. Debts may be paid in full or in part or discharged in either type of bankruptcy.

Usually where there is a Chapter 7 bankruptcy there are not sufficient assets to pay the community association.

An important distinction among the priority of debts in a bankruptcy is whether the debts are secured or unsecured. A community association which has filed a statutory lien under the Maryland Contract Lien Act or which has a recorded judgment against the debtor has a secured debt, secured by the real property in the association owned by the debtor. In most circumstances, a secured debt, or lien, whether it is a statutory lien or a judgment lien, will survive the bankruptcy with one important limitation. The debt may only be collected against real property, since after the bankruptcy the personal obligation of the debtor is discharged. The debt cannot be collected against personal assets of the debtor.

A member of a community association who files for bankruptcy but remains the owner of property in the association continues to be responsible for annual and special assessments which arise after the date the bankruptcy is filed. As said above, if a condominium unit owner moves out of the property, then he/she is no longer responsible for assessments after the move, but the property remains obligated. A homeowners association owner remains responsible whether or not he/she resides in the property after the bankruptcy.

One important protection of a bankruptcy is the automatic stay. When a debtor files for bankruptcy, creditors are automatically precluded from taking any \_\_\_\_\_ to collect pre-bankruptcy debts, or post bankruptcy debts against property which is subject to the bankruptcy. Even though a debtor is responsible for new debts which arise after the filing of the bankruptcy, the automatic stay prohibits any action until the stay is lifted by the court. There is a process for doing so, filing a motion for relief from the automatic stay. Action against the debtor while the automatic stay is in effect are prohibited and the penalties for violating an automatic stay are severe, including contempt of court findings and assessment of attorney's fees.

The practice in Maryland has been that when a motion is filed, if the debtor is represented by an attorney, the stay is conditionally lifted by consent, for relief from the automatic stay giving the debtor time to bring current any post bankruptcy arrearages.

If the debtor fails to do so, or fails to stay current, then the stay is completely lifted and the community association may proceed under the order lifting the stay with any remedies which are available.

Members of boards of directors of community associations should have an overview of the process whereby their annual and special assessments can be collected. However, because the

area is not carefully regulated by State and Federal law, boards are prudent to rely on competent professionals rather than to attempt self help. As said, the penalties for violating the Fair Debt Protection Act and bankruptcy laws can be severe.

## **Ch. 11 - OPERATIONS AND FINANCE**

### **BUDGET PROCESS**

#### **I. Introduction**

Without doubt, the most important recurring event in the life of any condominium, cooperative, town home or property owners' association is the preparation of the annual budget. That's when tentative plans are made to maintain, expand, or even reduce the community's operations. One of the most embarrassing moments for any board of directors is the discovery that expenses have exceeded income for no other reason than a poorly developed budget.

Governments, corporations, partnerships, sole proprietorships, and non-profit organizations all prepare annual budgets, but there's probably no place where the spotlight shines as brightly as on those responsible for them than in common ownership communities. The budget is used to determine how much money the community's owners will have to pay. Very few owners want to pay one penny more than will be needed. They expect a certain level of services to be provided, and don't appreciate being informed during the fiscal year that the budget was not sufficient to provide those services. Board members are like local politicians, and understandably feel "on the spot" when they have to explain such a turn of events to their fellow owners.

The annual operating budget is an exercise in planning income levels that will be sufficient to balance anticipated expenses during the coming fiscal year. A budget is not a spending plan or a commitment to undertake certain projects or contracts. Those commitments come later after votes are taken and contracts are signed. All things being equal, and barring significant unforeseeable surprises, actual income and spending levels should equal the forecast of the budget with relatively little deviation. It's no accident or luck when that happens. It's the result of good budgeting and good spending discipline.

The best time to start developing your next budget is right now! Many communities wait until "budget season" and then scramble to get it all done. Scrambling is a good way to make certain errors and oversights occur. Much of budget preparation is lengthy information gathering and organization, as well as making judgment calls. There's no need to wait until budget season to do all those things. Getting as much done as far ahead of time as possible makes the budget process less stressful and allows time for sober review of those judgment calls and any revisions that seem to be needed.

#### **II. Budget Philosophies**

There's no one "right" way to prepare a common ownership community budget. There are different approaches that reflect different philosophies about the subject. Some favor general budgets, while others favor detailed budgets. Some prefer a line item budget while others prefer a program budget. Some believe each amount in the budget must be calculated to the dollar, while others favor round sums. When is it permissible to develop the budget on the basis of the previous year's known costs, and when should a "zero-based" budget be developed? The best way to make these choices is by discarding previously held convictions and analyze what the budget is supposed to do and what the community and

its leaders need.

The first question that must be asked and answered is, “*What level of detail is needed in this budget?*” Small budgets with relatively few dollars split into many different categories can end up costing more in administration than the additional detail proves to be worth. On the other hand, a large budget divided into relatively few categories can leave board members and managers in the dark when spending overruns occur. As a general rule, begin with whatever level of detail has already been established and create additional details where circumstances appear to make it advisable.

**Line item budgets** divide projected income and expenses into known discrete categories. Most common ownership communities use a line item budget and group similar line items together into broad categories for convenience. For example, it’s useful to group all annual contracts that have a fixed cost. Since those contracts, once signed, are inflexible obligations, and their costs are fixed, they really can’t affect one way or the other, either the board’s or management’s control of costs.

**Program budgets** attempt to group together all income and expenses that are related to a “cost center” so it can be readily seen what that cost center’s impact is on the budget as a whole. This is a meaningful technique in business where it’s used to determine whether the cost of a particular center justifies its continued operation, i.e. is it paying its own way? Unfortunately, program budgeting in a common ownership community is only meaningful if the cost center is one where income, apart from assessments, can be adjusted to offset changing costs. Creating a cost center for the community swimming pool is somewhat pointless if the costs are paid from the assessments rather than admission charges.

Will the budget be a “**cost plus**” or “**zero-based**” budget? That’s one of the more important questions rarely addressed in most communities. Most community budgets are developed year after year by taking the most recent available cost data, and increasing it by a percentage factor (“cost plus”) that estimates the amount of change expected during the coming budget year. The problem is, over time, this approach leads to a budget that is nothing more than estimates built on estimates *ad infinitum*. The alternative, while more time consuming to develop, is to “start from zero,” hence the term, “zero-based.” It involves analyzing actual expenses, often for several years, determining which expenses were routine and can be expected to continue, and discarding those expenses that are unlikely to repeat.

For example, in developing a cost estimate for plumbing repairs in a 30 year old high-rise building, it’s likely a number of valves were replaced each year over the past several years. These are relatively costly repairs, but once all the valves have been replaced, it’s very unlikely more will have to be replaced until another couple of decades have passed. A cost plus budget might overlook that fact while a zero-based budget would discard valve replacement costs once all the valves have been replaced and develop an average (from several years’ experience) of more routine plumbing repair costs for the building.

As stated earlier, developing a zero-based budget is time-consuming. It should also be obvious that developing a zero-based budget every year is pointless. What to do? Perhaps the most practical answer is to apply “zero-base” budgeting to about twenty percent of the budget every year on a rotating basis. In that way, every part of the budget will get that kind of scrutiny at least every five years.

It’s wise to remember there are two other documents that portray the income and expenses of a common ownership community. **Budgets and accounting reports** deal with the same things, only at different points in time. One is a forecast, the other a history. It’s not only difficult to reconcile, but can actually result in much confusion and needless argument if the monthly or quarterly income and expense reports use a different level of detail than what is shown in the budget. For clarity and to minimize errors,

once a budget format is decided upon it ought to be reflected in precisely the same format in the monthly or quarterly income and expense reports. For that reason, discuss the proposed grouping of accounts with whomever is keeping the community's books to be sure they are comfortable with what is being contemplated.

The second document that represents the income and expenses of the community is the annual audit. Owners who watch every expense like a hawk, and fortunately every community has some of these, will attempt to correlate amounts shown in the audit with those represented in the budget. If the auditor is using different groupings than the budget and the income and expense reports, confusion and argument will ensue.

Once a budget format has been decided upon and duplicated in the monthly or quarterly income and expense reports, instruct the auditor to organize the income and expense statement in the audit to precisely follow that format. One further advantage of this approach is that it will enable past audited income and expenses to be included in a multi-year comparison of the community budget. Such comparisons provide a clearer picture of the evolving nature of income and expenses, and help to illustrate why assessments may need to change as well.

### **III. The Wrong Way to Budget**

Unfortunately, many common ownership community leaders forget the overall purpose of budgeting and approach it with their minds already made up about the outcome. That is, they strive to "force" the budget to balance despite projected increases so no increase in the monthly or quarterly assessment will be needed. In doing so, they do a tremendous disservice to their communities, even if many of the owners will regard them as local heroes for having done so.

The primary obligation of the board of directors of any common ownership community is to assure there are sufficient funds to properly maintain the community, not to keep assessments from going up. In fact, when a community goes several years without assessment increases, it's a virtual certainty that the maintenance and upkeep of the community will suffer. It's easy to understand why this is the case. Every community has certain costs whose increases cannot be controlled. Utility charges, salaries, insurance premiums and essential service contracts, to name just a few, usually increase no matter what the community does to prevent it. When these costs as a group increase even a little, and assessments don't increase along with them, then something has to be cut. That something almost always impacts the maintenance and upkeep of the community. This is transparently foolish when one realizes that everything structural and mechanical requires more maintenance and repair as it gets older. To ignore this reality ultimately will cost the community more money than it will ever save. It will also diminish the appearance of the community and make it a less desirable place to live. That will adversely affect its resale value relative to nearby communities that are better maintained.

### **IV. Budget Preparation Timetable**

The larger the size of a community's budget, the more time will be needed to properly develop it. Smaller communities may need less time, particularly if their budgets have a limited amount of detail. Quite apart from each community's time requirements are deadlines imposed by the community's governing documents. It's not uncommon for the bylaws to prescribe that the budget must be presented to the owners by a certain date for their consideration and comment prior to its final adoption by the board of directors. Some communities' bylaws actually require the budget be put to a vote of all the owners. Knowing and understanding a community's bylaws on budgeting may require consulting with a qualified and independent attorney.

For Maryland condominiums, there is an additional constraint imposed by the Maryland

Condominium Act. Section 11-109.2 of the Act states a condominium budget must be submitted to the unit owners at least 30 days prior to its adoption. Some condominium by-laws require the budget to be adopted at least 30 days prior to taking effect. This means the budget must be submitted to the unit owners at least 60 days prior to taking effect. The language of the Act and the language of the by-laws can, when compared to one another, appear to be overlapping or even contradictory. Condominium boards of directors are well advised to consult with their legal counsel to be sure their budget approval timetable meets the community's requirements as well as those of the Maryland Condominium Act.

There are several important objectives to be accomplished during the budget development process. The budget preparation timetable should be centered on an orderly accomplishment of each of these objectives. The objectives are based on estimating the funding requirements for:

- I. committee activities and projects;
- II. capital improvement projects;
- III. replacement reserve;
- IV. public utilities consumption;
- V. service contractors; and
- VI. staff payroll.

Insisting all committees submit their **committee activities and projects** funding requests allows the board to review these proposals as part of the budget development process. Once the proposal list is trimmed down to those deemed "politically acceptable," the next step is to develop a general idea of the likely cost of each proposal. This can be done by obtaining an estimate from a vendor or contractor. Only one estimate is needed at this stage; the intent is to get a general idea of the likely cost, not to conduct competitive bidding. The latter should be done only when it is known the funds have been budgeted and the community is prepared to commit to a contract. With a general cost estimate for all the committee proposals in hand, the board can then prioritize, again without specifically committing to any individual project.

Often committee members seem oblivious to the budgetary realities of the community. Getting the committees involved in the budget development process enables them to realize that funding their pet proposal cannot be considered outside the overall budgetary needs of the community. Once the budget is developed each committee can move forward focused on that which has been approved rather than wasting valuable time developing ideas that can't be funded.

**Capital improvement projects** are designed to enhance or improve the community rather than repair or maintain it. They should not be confused with replacement reserve projects. It's normal for a number of capital improvement projects to be on people's minds. The problem is one of timing. If the projects aren't discussed until the budget year is underway, it's probably already too late to fund them. That's why a good budget development process includes lead time for sounding out everyone on which capital improvement projects are desired. Then they must be prioritized since it probably won't be possible to fund all of them. Prioritization is usually accomplished by a combination of comparing the likely cost of each project as well as its true desirability. As you might imagine, the greater a project's likely cost, the more carefully it will be scrutinized to assess its real desirability.

The **replacement reserve** needs to be evaluated every year as part of the budget process. The primary question is whether any replacement reserve components are scheduled to be replaced during the coming budget year. If so, then the transfer of those funds from the replacement reserve fund into the operating account and its eventual disbursement must be provided for in the budget. This is also an opportune time, perhaps even the best time, to take a look at all the components in the replacement reserve schedule with a view to answering two questions: Does the projected remaining life of each component still look plausible, and has any information been obtained that would cast doubt on the

adequacy of the projected replacement cost? Sizable changes in the projected remaining life or the probable replacement cost of any item may alter the funding requirements of the reserve fund. That can also impact the budget.

As the percentage of the total budget devoted to **public utilities consumption** goes up, so does the need to develop a well thought out and rational projection of those costs for the coming budget year. Done properly, this can be one of the most difficult parts of the entire budget development process. It isn't rocket science, but it is time-consuming, so planning ahead is essential if there is to be enough time.

Conversely, forecasting the probable annual costs of the **service contractors**, the firms that provide essential and predictable services, such as trash collection, security patrols, etc., is one of the easiest portions of the process to complete. That is, of course, if your service contractors respond quickly to your queries. Once again, allowing some time takes the pressure off of them and you.

Finally, there is the matter of **staff payroll** projections. Not only can it be difficult to calculate the true cost of the payroll for the coming budget year, it's often wrapped up in politically sensitive discussions regarding how much of an increase and whether the benefits are adequate in today's job market. Some communities simply insert a lump sum into their budget and postpone facing these questions until the budget year is already underway. The problem with this approach is there will always be those who will view all the funds allotted in the budget as "spendable" without regard for whether there really is a need to spend them. Getting these tough decisions out of the way as part of the budget process can take the pressure off the Board during the budget year.

Most serious budgeting mistakes are made in haste, the result of too little time for too many decisions. The thrust of such a detailed budget development process is to make as many of the spending decisions as possible as part of setting the annual budget priorities, and to do so with enough "lead time" to permit a deliberate evaluation of all the issues that need to be considered. It helps all concerned to confront all these questions at the same time and to realize that the community very likely can't afford to do everything. Deciding these questions during the budget development process will allow the Board to concentrate on policy matters during the budget year rather than continually confronting new funding decisions.

## **V. Preparing the Budget**

### **A. Establishing the Chart of Accounts**

Preparing the actual budget begins with establishing the chart of accounts, making sure all those informed and educated estimates of future income and expenditures are organized into a logical arrangement. The chart of accounts is simply an organized grouping of the various categories into which all income and expense items will be distributed. While often overlooked, it's a good idea for the chart of accounts, indeed the very format of the budget, to look the same as the chart of accounts and format used in presenting the monthly or quarterly operating statement, also called the statement of income and expenses. Doing so simplifies comparisons of budget to actual during the year as well as year to year comparisons in the presentation of the annual budget each year.

Exhibit 1 (Suggested Structure of a Chart of Accounts) displays one possible structure for a chart of accounts. Of course, not every line item shown in the exhibit will actually be needed in every common ownership community. Neither, for that matter, is it absolutely necessary for every community to have its chart of accounts be as finely detailed. Smaller communities with smaller budgets can justify simpler charts of accounts. As a general rule, the larger a community's budget becomes, the greater the need for precision in the chart of accounts so all concerned can see "where the money goes."



Whether large or small, general or detailed, every chart of accounts is divided into several broad groupings, each of which will contain two or more distinct accounts. These are referred to as “line items.” The purpose of line item accounts is to segregate income and expense items so those who manage the community’s finances can more easily see where the real problems are when actual financial performance deviates unacceptably from the budget that had been adopted.

## B. Projecting Income

The real work in developing a budget begins with realistically projecting income. Of course, the largest part, **assessment income**, cannot be calculated until all of the other line item accounts, income and expense, have been calculated. Nonetheless, most common ownership communities have at least a few other sources of income.

Some of these line item income accounts are pretty obvious to just about everyone and need no explanation. However, there are a few income accounts often overlooked in budget presentations. The first is “**projected delinquencies**.” If a community never has any delinquencies, then it’s unimportant to show this line item. However, if there are a significant number of delinquencies, then it becomes very important. After all, a budget represents must balance income and expenses. A budget that shows income equaling expenses in a community with significant delinquencies will obviously become unbalanced if the delinquencies aren’t included in the budget forecast.

Another often overlooked or incorrectly treated income line item is “**interest income**.” Some communities intend interest income to be used to offset operating expenses, thereby minimizing the need for assessment income. Other communities intend interest earned by the reserve funds to remain in the reserves. Either way, it is necessary for interest income to be shown in the budget because it will be shown on the monthly or quarterly operating statements. How does interest earned by the reserves remain in the reserves if it is shown as income on the operating statement? That will be covered under “Projecting Expenses: “Transfers to Reserve.”

Yet another often overlooked income line item is “**transfers from reserve**.” When expenses are anticipated that will be paid from the reserve funds, those expenses will be shown as expenses on the operating statement, since all expenditures must appear there in one way or another. The only way to prevent those reserve expenditures from distorting the operating statement is by transferring funds equal to those expenditures from the reserve fund accounts into the an operating income account. For that reason, both transfers from the reserve accounts and transfers to the reserve accounts should be shown in the budget.

Finally, it is important to identify and account for any “**special assessments**” being collected from the owners in the community. Special assessments should never be lumped in with regular assessments. Doing so only clouds the question of how much money is budgeted, and collected, for each type of assessment, and where the delinquencies may be.

## C. Projecting Expenses

Operating expenses are normally separated into groupings of similar line item accounts for administrative, taxes and licenses, payroll, utilities, and maintenance expenses. All these, except maintenance, are fairly obvious and need no special explanation. However, since community management is fundamentally about maintenance, a community can often benefit from dividing its maintenance expenses into as many as three distinct groupings. If a community spends enough on maintenance, it will generally find it not only buys *staff supplies and equipment* for its own maintenance employees to use in doing their jobs, but will also enter into annual *service contracts* as well as “as-needed” *repair contracts*. The former are part of an annual routine, and are highly predictable in nature

and amount (trash removal, pool management, etc.). The latter are not specifically known before the actual need arises (i.e. a plumber hired to repair a broken water pipe). Segregating maintenance related expenses can give decision makers a better idea of where the money is going and whether increases can be controlled or even reduced. Ultimately, this kind of information can help the Board and/or management decide whether it's better to perform certain repairs with staff members or to out-source them to contractors.

Refer again to Exhibit 1 (Suggested Structure of a Chart of Accounts) for detailed examples of the following groupings. The actual chart of account for any particular community will vary, reflecting the community's individual needs and circumstances.

**Administration** expenses tend to be fairly predictable from year to year, unless a significant change is foreseen. If the community has its own on-site manager, it might be a good idea to separate and group those accounts for which the manager will be solely accountable from those that reflect the decisions of the Board of Directors.

**Taxes and Licenses** are also very predictable and don't tend to change significantly from year to year unless facilities are added that require licenses. That very rarely happens.

**Payroll**, if the community has employees of its own on site, can be a few accounts or several of them. It really depends on how many different types of employees a community has and how many of each type. A very small community with one manager, one engineer, and a couple of porters can justify grouping all their salaries into a single account. A very large community would do well to segregate salaries by employee type. Whichever method is used, create separate accounts for payroll taxes, insurance benefits, workmen's compensation premiums, and other benefits (such as bonuses, education benefits, etc.). Because they are payroll-related costs, it's preferable to include the premiums for health insurance and workmen's compensation under Payroll rather than lumping them in with the insurance premiums paid for the community's insurance policies.

Calculating a payroll budget, while somewhat time-consuming, isn't that difficult. The result can be a surprisingly accurate projection of future payroll costs. The challenge is to make sure every *foreseeable* cost is included. This is most easily accomplished by creating a spreadsheet with a line for each employee or position, then in each column across the page, insert:

Column 1.....	Current hourly pay rate
Column 2.....	Average number of work hours per week (max. = 40)
Column 3.....	Number of weeks employed per year
Column 4.....	Base yearly pay (Col. 1 x Col. 2 x Col. 3)
Column 5.....	Estimated number of overtime hours during the year
Column 6.....	Overtime pay rate <sup>1</sup> (usually 150% of hourly rate for non-salary employees)
Column 7.....	Yearly overtime pay (Col. 5 x Col. 6)
Column 8.....	Projected current base pay (Col. 4 + Col. 7)
Column 9.....	Annual pay increase (x% x Col. 8) <sup>2</sup>
Column 10.....	Estimated total projected yearly pay (Col. 8 + Col. 9)
Column 11.....	Employer's FICA contribution (6.2% of the first \$87,000 paid to each employee) <sup>3</sup>
Column 12.....	Employer's Medicare contribution (1.45% of all salary paid to each employee) <sup>3</sup>
Column 13.....	Federal unemployment insurance tax (6.2% of the first \$7,000 paid to each employee) <sup>3</sup>
Column 14.....	State unemployment insurance tax

(This percentage is limited to the first \$8,000 paid to each employee; the percentage itself will vary according to the employer's actual experience)<sup>3</sup>

Column 15..... Workmen's compensation premiums<sup>4</sup>

- <sup>1</sup> "Time and a half" for overtime unless other formulas are used (don't forget to include hours assigned to provide coverage of other employees on vacation, etc.).
- <sup>2</sup> If pay increases are given other than on January 1<sup>st</sup>, it will be necessary to adjust the amount to reflect the fractional part of the year.
- <sup>3</sup> Based on 2003 standards (check with community auditor annually because these percentages and salary limits can and do change often).
- <sup>4</sup> Workmen's compensation premiums should be calculated by employee because clerical employees cost less to insure than employees who are expected to move around the community or work around machinery.

The sums in Column 10 are assigned to the salary accounts and the totals for Columns 11 through 14 are assigned to their respective accounts. Similar calculations should be done for each employee receiving health insurance or other funded benefits. The totals are then assigned to those respective accounts in the Payroll grouping.

As with any other part of the budget, accurate forecasts depend in large part on being realistic about what expenses are likely to be incurred. Forecasting a lower payroll based on staff reductions isn't realistic if the vote to reduce to staff hasn't already been taken. Budgets should be based on existing conditions, not wishful thinking.

**Utilities** are, all too often, an area of the budget where numbers are just "snatched out of the air." As with payroll, forecasting utility costs may be time-consuming, but it's not all that difficult, and the results will be remarkably accurate when viewed over a period of years. It begins with locating the consumption history of each utility for the past several years. If yours is a new community, then your history is just beginning; use what is available. If yours is an older community, hopefully someone has been saving the old utility bills. If not, the utility company can provide a limited amount of prior history; it's better than nothing. The farther back your bills go, the better. However, recent history is most relevant.

Be careful to take note of any significant changes that would have had a marked effect on consumption. For example, installation of water saving devices throughout the community would likely result in a sharp decline in water consumption. If so, then the consumption history prior to the installation should be discarded. To do otherwise will skew the averages higher.

Create a spreadsheet, not just for each utility, but for each separate meter, and assign one line for each year for which consumption data is available. Then:

- 1) in the twelve columns across the page insert the consumption amount for that month's bill. Quarterly bills should be inserted in their respective months.
- 2) the annual total should be inserted in the thirteenth column. Note that there really shouldn't be significant variations in the annual totals unless some significant change has taken place that altered the prior consumption pattern.
- 3) total and average each monthly column.

Assume these monthly averages will be representative of what your community's actual consumption will be in the coming budget year. It may, in fact, be quite different; but it is unlikely a better, more objective, forecasting tool can be found.

"Rates" are the basis for determining the amount your community will be charged on each utility bill. Rates tend to increase, often at unpredictable times and in unpredictable amounts. Nonetheless, a good budget requires an effort be made to forecast those increases. Do this by contacting each utility company's public affairs office and develop a friendly relationship with a contact person there. This contact person can only give you the company's official line ("We have submitted a request for an 8% increase next year."), but that's a starting point.

Next, contact the Maryland Public Utilities Commission and see if they can give you some idea of what amount of increase is likely to be approved and when. It's uncommon for a public utility company to get the entire percentage it requests. Try to get a history of percentages requested vs. percentages granted. If the average percentage granted is half of that requested, then use that as the basis of your own calculations. Be sure to get some idea of when any increase is likely to take effect; it may be anywhere during your community's fiscal year. There's no point in calculating an increase for those months when the current rates will still apply.

The next step is to apply the formula the utility company uses in computing the bill to each of the monthly consumption averages. In the case of water and sewer charges, gas, and fuel oil, this will usually be very easy and uncomplicated. Where electricity is concerned, it's often very complicated. The formula is usually printed on each utility bill. Use that formula to calculate the amount of each month's or quarter's bill based on the monthly or quarterly consumption averages. The total for the year is the amount that should be inserted into the budget.

There may be some owners who will challenge this methodology. It is, after all, still based on assumptions and guesses. The best way to squelch those critics to challenge them to come up with a methodology of their own and to demonstrate its superiority. Easier said than done.

As stated above, all **Maintenance Expenses** can be segregated into three general categories: service contracts, repair contracts, and staff supplies & equipment. Service contracts cover costs by outside contractors associated with known and predictable services, such as landscape maintenance or elevator maintenance. Repair contracts covers all repairs performed by outside contractors when the nature of those repairs cannot be precisely foreseen until they are actually required. Staff supplies & equipment covers the purchase of all supplies, tools, and equipment used by the community's own maintenance employees in the performance of their duties. Dividing maintenance expenses in this manner allows the community to better evaluate their maintenance alternatives as well as monitor where their maintenance dollars are really going.

**Service Contracts** are probably the easiest part of the budget to forecast. Contact the contractors and ask them when and how much of an increase in their contract you should anticipate. If you can actually get them to send a contract or a letter or fax committing them to these increases, so much the better. Of course, if there's a possibility of changing contractors, the problem becomes a little more difficult. If the reason for the change is dissatisfaction with the service provided, then it may cost more for another contractor to commit to providing a satisfactory level of service. If this is the case, consider soliciting a proposal from one contractor and use that as the basis for the budget estimate. Additional proposals can be solicited when you're actually ready to make the switch.

Bear in mind these accounts should be used only for the contract charges. Some contractors may, in the course of their work, be asked to perform additional services not specified under their service contract. Those charges should be charged to an appropriate Repair contracts account.

More than any other area of the budget, **Repair Contracts** calls for "guess-estimation." Once again, this second grouping of accounts under the general heading of Maintenance Expenses should be limited to expenses paid to outside contractors. You may know, from experience, that plumbing repairs

will be needed, but there's no precise way to know what kind, how many, or what they will cost in every case. Obviously, the community's experience over the past few years is the best possible starting place, then add any known costs, such as the expected replacement of a pump or motor that really needs to be replaced.

Since this grouping of accounts is so difficult to "guess-estimate," one technique often used is to make sure the total for all the accounts in this grouping is as much as was actually spent in the past year, then add a percentage to allow for inflating costs and increasing repair incidents. It may ultimately turn out that some line items will actually do better than budgeted while others do worse, but the bottom line for the grouping should be relatively close to the budgeted estimate.

The final grouping of accounts under the general heading of Maintenance Expenses is **Staff Supplies & Equipment**. These accounts should be used to record all expenses for materials, supplies, tools, and equipment used by the community's maintenance employees in the course of doing their jobs. There are two good reasons for tracking these expenses separately from contractor expenses. First, it's impossible to increase the size of the maintenance staff simply by adding dollars to the payroll budget. Each employee, to do his or her job, must be equipped with the various tools, parts, and supplies that are inherent to the job task. The second reason is to have a clear basis for deciding whether it is better to have the community's own staff perform the maintenance or to out-source it to contractors. Clear delineation of these kinds of expenses takes away much of the guesswork in choosing between in-house staff versus out-sourcing.

Sometimes expenditures are planned for additions and improvements rather than maintenance and replacement reserve projects. **Capital Improvements** are tangible commodities, such as new (not replacement) furniture or shrubs purchased to upgrade the community. Placing such planned expenditures in a separate category is desirable because, from year to year, this category of accounts can vary considerably depending on how much money is available to how much the community wants to improve. If only a few small individual projects are planned, it's perfectly acceptable to group them together in one account. However, if there is more than one large dollar project being planned, creating separate accounts for each is a good idea. That will enable everyone to track actual expenses to what was budgeted.

Earlier it was pointed out that all expenses, regardless of their nature, must appear in the statements of income and expenses. **Reserve Projects** is an account or a group of accounts that will be used to identify anticipated reserve outlays during the budget year. It normally would equal the amount shown as "Transfers from Reserves" under income, although it is possible it may be less with the difference made up by other income. As with "Capital Improvements," one account can be used if the total anticipated outlay is small. However, if more than one large dollar project is planned, then separate accounts will facilitate all concerned in tracking actual expenses to those budgeted.

Last, but by no means least, is **Transfers to Reserve**. This single account displays the sum anticipated to be transferred from the regular assessments into the Replacement Reserve fund or accounts. As a general rule, this sum should equal that sum calculated from the most recent Replacement Reserve study and adjusted upwards or downwards to reflect over- or under-funding of the Replacement Reserve. If it's intended that interest earned by the reserves remain in the reserves, then the amount of interest reflected in "Interest Income" should also be added to whatever other sums are planned for transfer to reserves.

An often overlooked matter in replacement reserve funding is allowing for the effects of inflation. If your community's most recent reserve study was three years ago (many communities have such a study done every three to five years), then the projected replacement costs of those items in the study are likely

to have increased during the intervening period as a result of inflation. There are a number of ways to offset these increases, and a discussion of budgeting is not the appropriate place to discuss them. Suffice to say, the subject should be given some thought and the adjustment, if need be, factored into the Transfers to Reserve account.

## VI. Reserve fund activity

The foregoing discusses the intricacies of preparing and presenting an "operating budget." However, what no operating budget does is illustrate the activity taking place in the Replacement Reserve fund. Owners are entitled to an accounting of that as well, and it's quite simple.

<u>Replacement Reserve Fund Activity:</u>	<u>Last year</u>	<u>This year</u>	<u>Next year</u>
Prior year end fund balance....	\$	\$	\$
<i>plus:</i> Transfers to Reserve			
<i>minus:</i> Transfers from Reserve			
Year end fund balance..	<u>\$</u>	<u>\$</u>	<u>\$</u>

This simple display of income and outlays will quickly answer a great many of owners' questions about how the Replacement Reserve fund is doing.

## VII. Five Year Budgets

It is a regrettable fact that nearly all common ownership community boards of directors plan their community's finances no more than a year ahead. Yet long term financial planning should be part of the budgeting process. Perhaps it's not often done because the usual reaction is, "How can you plan that far ahead?" Actually, it really isn't that difficult to develop a five year budget once the annual operating budget has been completed. Five year budgets provide a good picture of how much of each year's assessment income will be consumed by essential, or "un-cutttable," spending. The remainder of the assessment income is then available for non-essential, or discretionary, spending, such as capital improvements. Providing this information to the owners as well as to the Board can give everyone an early warning of the likelihood of future assessment increases.

It's neither necessary nor advisable to present a five year budget by displaying all the line item accounts shown in the annual operating budget. Instead, the line items in a five year budget really need to be only the subtotals of each grouping of accounts, as shown below:

	<u>Next Year</u>	<u>N.Y.+1</u>	<u>N.Y.+2</u>	<u>N.Y.+3</u>	<u>N.Y.+4</u>
Assessment Income .....	\$	\$	\$	\$	\$
Projected delinquencies .....					
Interest income.....					
Transfers from Reserves.....					
Special assessments					
<i>Total income</i>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Administration	\$	\$	\$	\$	\$
Taxes & licenses					
Payroll					
Utilities					
Service contracts					
Staff supplies & equipment					
Capital improvements	0	0	0	0	0
Reserve projects					

Transfers to Reserves					
<i>Total expenses</i>	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
Surplus or deficit .....	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____

The key, as with all budgets, is to be realistic about income and expenses. Begin by assuming the current assessment level will remain constant, since the object of a long-range budget is to get a long range view of needed increases in assessments. Assume all other income and expenses will still be present unless you know for a fact that one or more will “drop out.”

If a particular income or expense item is known or can be reasonably assured to remain at the same cost level in each future year, then show it as such. But if the recent history of the community shows increases, then allow for future increases. How much? One method is to average the past recent increase percentages and apply that percentage to each successive year. Of course, if there is a service contract that specifies the amount to be paid in future years, then those amounts should be shown accordingly.

### VIII. ....Presentation and Format

Whether from its inception or only when it's finally complete, the budget must eventually be formatted for presentation to the owners. What it looks like can mean just as much as what it says. A well-formatted budget conveys a sense of authority and expertise; a poorly formatted budget calls into question the very competence of those who prepared it, no matter how hard they may have labored in the process.

Exhibit 2 shows a sample format for presenting a budget. It presents the previous year that's been audited, the current year in budget, year-to-date, and projected year end amounts, and the next fiscal year. Also shown is a column of percentage changes between the current year's budget and the projected budget. Using this format from the very start of the budget development effort is advantageous. It provides everyone involved with a continuing visual reminder of all that needs to be done as well as the opportunity to see each of the pieces as a part of a larger whole.

While this format can be assembled on a typewriter from handwritten worksheets, as well as on a computer using a word processor, assembling it on a computer by means of a spreadsheet program, such as Microsoft Excel, will greatly simplify the process of recalculating the totals each time a change is made. Creating the format, including the appropriate calculation formulas, also provides a ready starting point for the budgets in later years.

However, a spreadsheet with columns of dollar amounts is not, in and of itself, enough. Those numbers will result in questions being asked, such as: “What's included in this account?” “Why is there such a big difference between this year's amount in this account and next year's projection?” “How was this estimate calculated?” Such questions can be anticipated and answered in advance by means of a narrative description of each line item and how the projected budget amount was calculated. If there are significant differences between the past or current year and the upcoming budget year, those should also be explained in the narrative. The absence of a narrative description can appear to skeptics as evidence of something being hidden. On the other hand, a well written narrative description will make the budget look authoritative and convey the impression that not only was the budget carefully constructed, but that the board of directors is being pro-active in providing answers to those questions that can reasonably be anticipated.

## **Ch. 12 - Transition from Developer to Owner Control**

### **Introduction**

The developer generally controls the Board until the community is sold out, or only a few remain for sale. Because the developer's objectives in building the community are different from the residents' goals, conflicts can occur between the community and developer during the transition process. The process described below can facilitate the transition process.

### **Public Offering Statement and Community Documents**

These are the legal documents that create the community, define its boundaries, divides maintenance and repair responsibilities, and sets the bylaws for the community. The documents are voluminous and often hard to understand, however they are the basis from which the community will operate. Every original owner in the community is supposed to receive a copy of these documents. They should be kept for future reference.

### **Division of Ownership, Maintenance, Repair, and Replacement Responsibilities**

Public Offering Statements contain drawings and written descriptions defining community and private property. They also contain charts that define maintenance, repair, and replacement responsibilities. It is important to clearly understand the boundaries and responsibilities since the same component can have different ownership in different properties. For example, in some condominiums windows are owned and maintained by the Condominium Association, while in others the windows are owned and maintained by the unit owners.

### **I. Developer Warranties**

The developer provides unit or home owners with warranties for their property. These warranties are described in the Public Offering Statement and are different from the warranties for community property. Unit or home owners are responsible for dealing with the developer for their private property. Community Associations are responsible for dealing with the developer for community property.

### **II. Statutory Warranties**

Maryland law mandates the following statutory warranties that the developer must provide. (add brief description)

The developer can provide additional warranties, but this is rare.

### **III. Construction Defects**



By law, in condominiums the developer must provide a warranty against “structural defects” for a period of two years following conveyance of the first unit to a buyer. Homeowner associations do not have this statutory warranty period.

In Maryland law, a “structural defect” is a condition that affect the stability or safety of a building, or a condition that prevents the component from performing its intended function. Other types of construction defects include cosmetic defects or defects that do not prevent the current operation of a system, but that will cause premature future repair or maintenance concerns.

It is advisable for the condominium association to identify construction and structural defects during the two year warranty period so that the developer can be notified to make corrections. This process of discovery and notification is discussed in more detail below.

#### **IV. Bonds**

Developers must post bonds with the local authorities to make sure that community property and components that are used by the public meet local and state standards. Local building code, public works, utilities, and zoning officials typically inspect the property and release the bonds when they are satisfied that all requirements have been fulfilled.

The primary leverage that homeowner associations have with developers to correct community property construction defects is to hold up bond release. The homeowners association does not have the authority to withhold bond release, but local authorities are normally reluctant to release bonds if the community has significant unresolved concerns with public property.

#### **V. Board Transition**

The Public Offering Statement defines the procedures for transition of the Board from developer to Association control. This transition usually occurs over a period of time with the Association having a minority representation on the Board, that changes to majority representation, and finally all developer Board representatives leave. At condominiums, the community generally assumes complete control of the Board before the two year statutory warranty period expires.

#### **VI. Management Transition**

At condominiums and larger homeowner associations, the developer usually retains a property manager to administer community business. The property manager works for the community association. When the community assumes majority control of the Board, they can change management companies if they are not satisfied with the performance of the developer’s choice of managers.

#### **VII. Service and Maintenance Contracts**

During the build-out process, the developer may use building subcontractors to service and maintain the property. As the transition process proceeds, the Board needs to review service and maintenance contracts to make sure that all necessary work is covered, and that the firms doing the work are appropriate.

### **VIII. Documents and Files**

The Association needs to obtain from the developer all documents relevant to the design and operation of the property. These documents include the following.

- A complete set of all design drawings, including site plans, utility plans, building plans, and landscaping plans. “As Built” drawings are rarely made in modern construction. Such drawings, if available, are the best to use, but builders rarely pay to have as-built drawings made.
- The design specifications. Specifications are detailed descriptions of the requirements for the various products used in construction. They are usually in a bound volume separate from the plans. For smaller projects, the specifications may be on the plans. Specifications are sometimes valuable, but the plans are more important. This is because the specifications are most often standard documents generated by computer that are not coordinated with the plans. The specifications often do not reflect the products actually used in the buildings, and may often be misleading.
- Testing and inspection records. During construction, independent firms test and inspect various components. Common examples are soils tests, fire alarm system test, concrete tests, and air balance tests. Copies of these test reports should be provided by the builder to the Association.
- Permit inspections. Local building code authorities, or their designated independent inspection firms, inspect the building at various stages of construction. Copies of these inspection reports should be provided by the builder to the Association. In some cases, the inspectors place certificates of approval on the equipment. An example is the stickers placed by the electrical inspectors on main breaker and disconnect panels.
- All warranties on property components.
- Operating and maintenance manuals for equipment.
- Public Offering Statement and Condominium Documents.
- Budgets and reserve schedules.
- Lists of unit or home owners and all file information on the units necessary to administer the community.

### **IX. Communication with the Community**

During the transition, it is essential that the Board keep the community advised of the status of negotiations with the developer. However, dissemination of sensitive information that could affect the negotiations should be tightly controlled. Finding the proper balance between full

disclosure to residents and withholding sensitive information that should not be seen by the developer can be challenging.

## **X. Assessment of the Property for Construction or Structural Defects**

Many defects do not become apparent immediately. It is best to wait until near the end of the two year statutory warranty period to perform a systematic assessment.

It is advisable to distribute a structured questionnaire to residents before performing a systematic property assessment. Patterns of concerns may become apparent when responses from a large group of residents is examined.

Most communities retain an engineer or building inspection firm to perform a systematic assessment of the property. This is not required by law or the community documents, but it is advisable to have professionals do an assessment since it requires special knowledge to evaluate complex building systems.

Many critical systems are concealed and cannot be examined without cutting holes in finishes, or demolishing parts of a building. Examples include piping and wiring inside walls and ceilings, exterior wall flashing behind the cladding, waterproofing under pavement or landscaping, buried piping, pipes and wiring buried in insulation in attics, and structural components concealed by finishes. In assessing these items, common practice is to search for indications of problems with concealed components. If there is sufficient reason to suspect that there are concealed defects, then it may be decided to cut exploratory openings. Otherwise, significant costs could be wasted in cutting open walls and ceilings in a random manner looking for problems.

Testing equipment and systems should be done as a building is commissioned. The building engineer should participate in this process since it can take a long time to completely test complex building systems.

The legal authority of the Association's physical assessment extends only to common element components. The condominium documents define these components. Some concerns may involve a combination of common and unit owner elements. For example, in buildings with central plants that provide hot or chilled water for a common element central plant to terminal equipment owned by the unit owners, it is possible for improper operation to be from defects in the central plant, piping, terminal devices, or a combination. It is important to identify the physical problems first, and then assign responsibility for repairs.

An independent design review of a property is not a normal part of a transition study because it would be time consuming and costly for a consultant to check all of the design assumptions and details in a property. If a complete set of design drawings is available, they normally contain sufficient information for an independent consultant to assess the adequacy of important components. Most design drawing sets contain a detailed listing of the general building code

criteria that were used to design the building. Many drawings contained detailed assessments and/or calculations of some items required by local jurisdictions for code compliance.

### **Replacement Reserves**

It is cost effective to incorporate a reserve study with a transition study since they both involve many of the same tasks.

Developers often underestimate an appropriate level of reserve contributions. This is usually not a deliberate effort to understate reserve assessments, but it reflects a fundamental difference in point of view between builders, who focus on new construction, and property managers, who maintain existing facilities. A developer may believe that the cost to replace a component is about the same as the original construction cost. However, in most cases it is more costly to replace components in occupied buildings since contractors must work around the residents, and old components must usually be demolished or removed first.

### **Negotiations and Resolution of Disputes with the Developer**

After a list of alleged defects is compiled, the Board should initiate a negotiation with the developer to have the defects corrected. If the defects are minimal, there may be no disputes and the developer will promptly correct the problems. However, it is more common for Associations to have a list of defects that is disputed by the developer. The method of handling these negotiations varies with circumstances. Many communities retain attorneys to assist with the negotiations. Available options include the following.

- Informal negotiations. The Board, developer, attorney, and professional inspector work together to come to an agreement about the items to be corrected and the method of correction. This is the most common method of handling transition disputes.
- Mediation. An independent third party is engaged to help the parties reach a resolution. This is appropriate when the issues are limited and the cost to correct is moderate.
- Litigation. The Association can bring a lawsuit to compel the developer to correct defects. Preparation for litigation is very costly and there are no guarantees that the Association will prevail or recover the cost of litigation. This method should only be employed when the cost to correct defects is very high and the parties cannot reach agreement through the other two methods.

## Ch. 13 - CCOC AND THE MEDIATION PROCESS

The Commission's statutory mission is, among other things, to advise the County government on ways to "reduce the number and divisiveness of disputes" between common ownership communities governing bodies and their residents. As part of this, the Commission is to ascertain ways to "encourage informal resolution of disputes."

The legislation creates a dispute resolution process under which parties can voluntarily agree to mediate disputes that fall under the jurisdiction of the CCOC. However, if there is no agreement to mediate, or if mediation fails, the Commission is authorized to enter into a formal contested hearing similar to, but not identical with, a civil court proceeding. Such a hearing and its documented memorandum decision and order has the force of law and is recognized by appellate courts as binding and enforceable.

Since the CCOC was created there has been an increasing number of such formal proceedings, which has requires the investment of considerable time and effort on the part of Commission members and attorneys who volunteer to act as panel chairs. Recently, a question has been raised as to whether a more effective way of resolving disputes is possible, which can result in a more efficient use of the Commission and these attorneys, all of whom serve on a *pro bono* basis without pay.

This would be desirable also if such approach could lead to conciliation among the disputants, who must continue to live with one another in their associations, and free the Commission for other responsibilities.

The Montgomery County Attorney has recently advised that associations must be represented by attorneys in formal proceedings before the CCOC. This can pose a problem for smaller associations with limited budgets who may not be able to afford an attorney, and possibly result in a miscarriage of justice. Such results possibly may be obviated by the use of less formal procedures.

As a first step--an experimental one--the CCOC decided to encourage greater use of mediation. To this end, the County is negotiating a memorandum of understanding with the Conflict Resolution Center of Montgomery County, which has been funded in part by the Maryland Mediation and Conflict Resolution Office. This latter office was created to implement alternative dispute resolution techniques in the courts, and is championed by Judge Bell, Chief Judge of the Maryland Court of Appeals.

Rule 17 of the Maryland Rules of Court encourages Circuit Court use of mediation as well as other dispute settlement procedures short of formal trials. We also plan to explore the use of such other procedures in an effort to effect a more efficient and amicable settlement of disputes, and avoid the inevitable increase in hostility and costs characteristic of formal adjudication proceedings.



## Ch. 14 - Owner and Association Resources/Links

### 1. Applicable State Laws

- A. Maryland Condominium Act: MD Stat. Anno. §11-101 *et seq.*  
[http://www.dsd.state.md.us/comar/Annot\\_Code\\_idx/RealPropIndex.htm](http://www.dsd.state.md.us/comar/Annot_Code_idx/RealPropIndex.htm)
- B. Maryland Homeowners Association Act: MD Stat Anno. §11B-101 *et seq.*  
[http://www.dsd.state.md.us/comar/Annot\\_Code\\_idx/RealPropIndex.htm](http://www.dsd.state.md.us/comar/Annot_Code_idx/RealPropIndex.htm)
- C. Maryland Cooperative Housing Corporation Act: MD Stat. Anno. §5-6B-01 *et seq.*
- D. Maryland Non-stock Corporation Act:  
[http://www.dsd.state.md.us/comar/Annot\\_Code\\_idx/CorpAssocIndex.htm](http://www.dsd.state.md.us/comar/Annot_Code_idx/CorpAssocIndex.htm)
- E. Maryland Contract Lien Act: MD. Stat. Anno. §14-201 *et seq.*  
[http://www.dsd.state.md.us/comar/Annot\\_Code\\_idx/RealPropIndex.htm#Title%209](http://www.dsd.state.md.us/comar/Annot_Code_idx/RealPropIndex.htm#Title%209)

### II. Applicable County Codes

- A. Montgomery County Code, Chapter 10B  
[http://www.amlegal.com/mcmd\\_next/gateway.dll/Maryland/Montgomery%20County/Montgomery%20County%20Code/part00004/chapter00024.htm?fn=document-frame.htm\\$f=templates\\$3.0](http://www.amlegal.com/mcmd_next/gateway.dll/Maryland/Montgomery%20County/Montgomery%20County%20Code/part00004/chapter00024.htm?fn=document-frame.htm$f=templates$3.0)
- B. Common Ownership Communities
- C. Mediation Program

### III. County Resources

- A. Montgomery County Department of Housing and Community Affairs  
<http://www.montgomerycountymd.gov/apps/dhca/index.asp>
- B. Division of Consumer Affairs  
<http://www.montgomerycountymd.gov/dhctmpl.asp?url=/Content/DHCA/consumer/consumer/consumer.asp>
- C. Montgomery County Commission on Common Ownership Communities  
[http://www.montgomerycountymd.gov/dhctmpl.asp?url=/Content/DHCA/consumer/ccoc/ccoc\\_index.asp](http://www.montgomerycountymd.gov/dhctmpl.asp?url=/Content/DHCA/consumer/ccoc/ccoc_index.asp)
- D. Housing Opportunities Commission for Montgomery County  
<http://www.hocmc.org/>

### IV. Government Resources Directory

A. Federal Resources

1. Federal Courts

<http://www.law.emory.edu/FEDCTS/>

2. Federal Laws

<http://findlaw.com/casecode/>

3. Federal Agencies and Commissions

<http://www.whitehouse.gov/government/independent-agencies.html>

V. Maryland - Other Resources

A. Maryland Courts

<http://www.courts.state.md.us/>

B. Maryland General Assembly

<http://mlis.state.md.us/>

1. Senate

<http://www.mdarchives.state.md.us/msa/mdmanual/05sen/html/sen.html>

2. House of Delegates

<http://www.mdarchives.state.md.us/msa/mdmanual/06hse/html/hse.html>

3. Department of Legislative Services

<http://dls.state.md.us/>

C. Maryland Agencies

[http://www.maryland.gov/help/EN/mp\\_agency\\_index.html](http://www.maryland.gov/help/EN/mp_agency_index.html)

D. Maryland State Government Official Web Portal

<http://www.maryland.gov>

E. Maryland Secretary of State

<http://www.sos.state.md.us/>

F. Office of the Attorney General

<http://www.oag.state.md.us/>

G. Maryland Department of Housing and Community Development

<http://www.dhcd.state.md.us/Website/home/index.aspx>









